REPO CRISIS

The Mother of All Crises Nobody Will Discuss

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Preface

There arrives a time when the sins of the past come to demand their retribution. I warned that the structural design of the euro was a complete disaster. The Repo Crisis is emerging because of this structural design flaw that has placed the entire world at risk of a financial disaster beyond all proportions of the 2007–2009 Financial Crisis. Due to this structural crisis in Europe, there is nothing external international central banks can do to prevent this crisis, no less manage the fallout.

We face a global contagion never witnessed before in economic history. On top of that, we have fiscal irresponsibility clashing with monetary policy of central banks and there is no referee standing between this clash of titans. Furthermore, we have absolutely the worst possible political catastrophe unfolding where people who have true qualifications to manage a financial crisis of this magnitude have no interest in even coming close to politics.

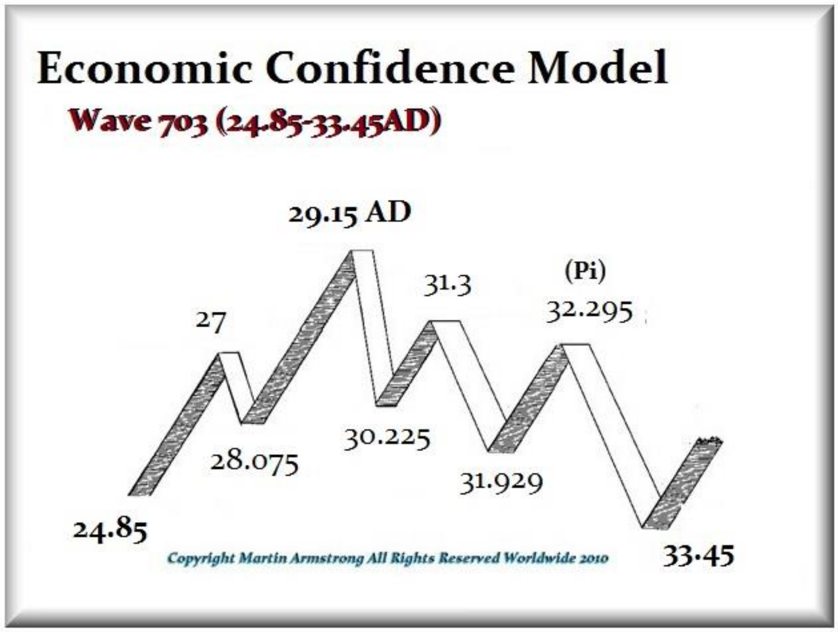
The analysis of this Repo Crisis has been the traditional domestic focus spun by people who have zero experience in international world capital flow analysis, economics, or basic comprehension of how the world economy operates.

So, sit down. We are about to explore a crisis hitherto unknown to economic history. We lack economic theories to describe what is taking place and do not understand the nature of the beast we must confront.

The Undiscovered Global Economy

One of the most frustrating realities about our political economy is that all the various theories are predicated upon a basic assumption that domestic economies are entirely autonomous and can be controlled by the local government. Politicians run for office and promise change in every election as if the economy was totally independent. They never consider that we have a global economy or understand just how interconnected we truly are today. Oh, there are complaints about trade wars, but never is there a true understanding that politicians cannot possibly alter the direction of our respective economies, for they cannot control events beyond their own borders.

Moreover, it is absolutely impossible for any government to manage its own domestic economy. An external crisis can impact a domestic economy and spread like a virus before becoming a global financial–economic contagion. What is even more astonishing is that we hear about foreign actors, like China, impacting trade and absurd allegations that Russia influenced the 2016 US election, which has led to claims that even Brexit was orchestrated by Russia. None of these allegations have any validity to them and by no means has the United States been the innocent victim when it comes to political interference in the elections of other countries from Canada to Europe, Russia, and throughout Asia.



The world economy has always been interconnected since the ancient days. When Roman Emperor Tiberius (14–37 AD) came to power in 14 AD, he was intent upon ending the liberal spending habits of his predecessor Augustus (27 BC–14 AD). He imposed limitations on credit to curtail the real estate speculation. In modern terminology, Tiberius imposed austerity by requiring that two-thirds of every loan be invested in Italian land to reduce the speculation in the provinces, which had become the emerging markets for Roman investors.


Tiberius
(14-37AD)

Additionally, Tiberius decreed that two-thirds of every loan should be repaid. Tiberius was imposing massive deleveraging within the economy, which would have been tremendously deflationary. His actions fell precisely in line with the Economic Confidence Model Wave #703 that saw the economy decline into 33 AD.

The Senate was also deeply involved in the real estate speculation. To protect their own self–interests, the Senators implemented an 18–month stay to allow those impacted by these laws to settle their affairs before final judgment.

By restricting loans to Italian land and then ordering two–thirds of such debts paid–off, this too set in motion the collapse in real estate especially in the provinces or the emerging markets of ancient times. Loans were now called in to be paid in full. Debtors were forced to sell, and the market was flooded with real estate as prices collapsed. Combined with Tiberius' restriction on credit, he also contracted government spending. This reduced the supply of new money entering the economy since there were no public debts. What Tiberius unleashed was a tremendous shortage of money that caused the velocity of money to collapse.

There was a severe shortage of money. It was during the reign of Tiberius that we see a host of tokens privately produced to compensate for the shortage of coinage. We saw precisely the same response during the American Civil War, the German hyperinflation with private issues of Notgeld, and Depression Scrip of the

1930s with over 200 American cities issuing their own private money to allow commerce to take place.

Tiberius also set in motion a contagion with banking failures as people could not pay off their loans as prices collapsed. The banking firm Seuthes and Son of Alexandria was a firm facing difficulties because of the loss of three richly laden ships in a Red Sea storm. That event was followed by a fall in the value of ostrich feathers and ivory, on top of the collapse in real estate values. Nearly at the same time, there was the house of Malchus and Co. of Tyre with branches at Antioch (Syria) and Ephesus (modern Turkey). They suddenly became bankrupt as a result of a strike among their Phoenician workmen and the embezzlement of a freedman manager. These two failures also affected the Roman banking house Quintus Maximus and Lucious Vibo that was operating in the Roman forum. Even in ancient times, bankers were intricately connected internationally.

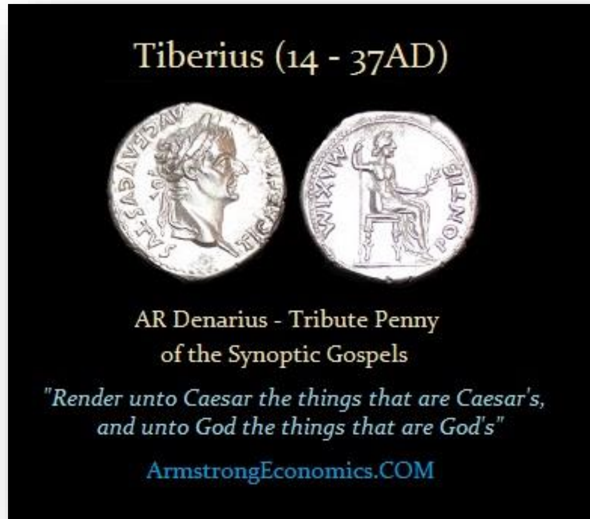
Roman Wall Street in the Forum - Via Sacra

These events set in motion bank runs, which then impacted another major Roman banking house of the Brothers Pittius. The Wall Street of the day in the Forum was the Via Sacra, which erupted in panic as merchants were impacted by the collapse in banking and money supply. There was also a rebellion among the people of Northern Gaul, so the emerging markets outside of Italy went into crisis as well. Money was contracting as nobody would lend and hoarding soared. Tiberius' austerity had created a major financial crisis. This is the same result we have witnessed in Europe post–2007, which has only worsened due to the imposition of negative interest rates that are destroying the incentive for capital to lend under these conditions.

When Publius Spencer, a wealthy–noblemen, requested 30 million sesterces from his banker Balbus Ollius, the firm was unable to fulfill his request and closed its doors. Over the next few days, prominent banks in Corinth, Carthage, Lyons, and Byzantium all announced they had to also "rearrange their accounts." The banking panic and the closure of several banks along the Via Sacra in Rome devasted the economy because of Tiberius' austerity policy.

As the crisis spread throughout the empire, banks began calling in their loans on everyone in an attempt to raise capital. Tiberius created one of the first documented global contagions in economic history. When debtors could not meet the demands of their creditors, they were forced to sell their homes and possessions. With money unavailable even at the legal limit of 12% interest, the economy plummeted down into deflation. The prices of real estate and other goods completely collapsed in a downward spiral of deflation. The purchasing power of money rises against assets during such contractions.

A full–scale financial panic was sweeping the entire Roman Empire. It has been argued that the crucifixion of Jesus was also in the midst of this financial crisis, which played a role in Pontius Pilate's judgment since he was appointed by Tiberius in 26/27 AD and served until to 36/37 AD. There was a tax revolt in Judaea during this period of economic crisis.



While the Bible infers that they were seeking to entrap Jesus "to hand him over to the power and authority of the governor" (Luke 20:20), we must also take into account that this crisis was impacting the entire Roman world. In the Gospel of Mark (12:15) they asked Jesus "Should we pay or shouldn't we?"

Jesus asked one of them to produce a Roman coin that would be suitable for paying Caesar's tax. They showed him a Roman coin, and he asked them whose head and inscription were on it. They answered, "Caesar's," and he responded, "Render therefore unto Caesar the things which are Caesar's; and unto God the things that are God's."

Scholars have provided estimates for the year of Jesus' crucifixion in the range 30–33 AD, and many believe the year was 30 AD. Based on the economic history, I would be more inclined to place this during the financial crisis on the fourteenth of Nisan (April 7) during the year 33 AD, for Tiberius was not compelled to respond until after the financial crisis created a global contagion.

The Financial Panic of 33 AD became so severe it forced Emperor Tiberius to implement what we would call Quantitative Easing. Eventually, the decrees that had precipitated the problem were suspended. Then 100 million sesterces were to be taken from the imperial Treasury and distributed among reliable bankers to be loaned to the neediest debtors. A loaf of bread sold for half a sestertius and soldiers earned around 1000 sesterces annually. Therefore, this financial crisis sent the purchasing power of money drastically higher.

Tiberius responded making loans interest free — not negative. Furthermore, no interest was to be collected for three years. Security was to be offered at double value in real property. This enabled many people to avoid selling their estates at distress prices, arresting the contraction in prices and ensuring that the lack of liquidity would be addressed. Many banks just never survived.

The policies imposed by Tiberius are no different from the policies imposed by the US Congress when the Democrats came into power and changed the laws to also stop the real estate speculation. Those misguided regulations led to the S&L Crisis (1986–1995) as property values collapsed and banks failed.

The 1986 mid-term election during the Reagan administration created the S&L Crisis. Democrats won a net gain of eight seats to recapture control of the United States Senate, taking back the chamber for the first time since the 1980 elections. They won the national popular vote for the House of Representatives by a margin of 7.7%, making a net gain of five seats. They then reversed the regulation benefiting real estate investment by creating a one-way sell incentive, which caused property values to collapse. The S&Ls were regulated to lend into real estate and they began to collapse because of the tax code changes.

The S&L Crisis cost $160 billion. Taxpayers paid $132 billion, and the S&L industry paid the rest. The Federal Savings and Loan Insurance Corporation paid $20 billion to depositors of failed S&Ls before it went bankrupt. More than 500 S&Ls were insured by state-run funds. Their failures cost $185 million before they collapsed.

Nobody Ever Asks – Has This Been Tried Before?

What is truly astonishing is the complete lack of any understanding of economic history. Governments attempt the same stupid things time and time again without ever asking, "Has this ever been attempted previously? What was the result?"

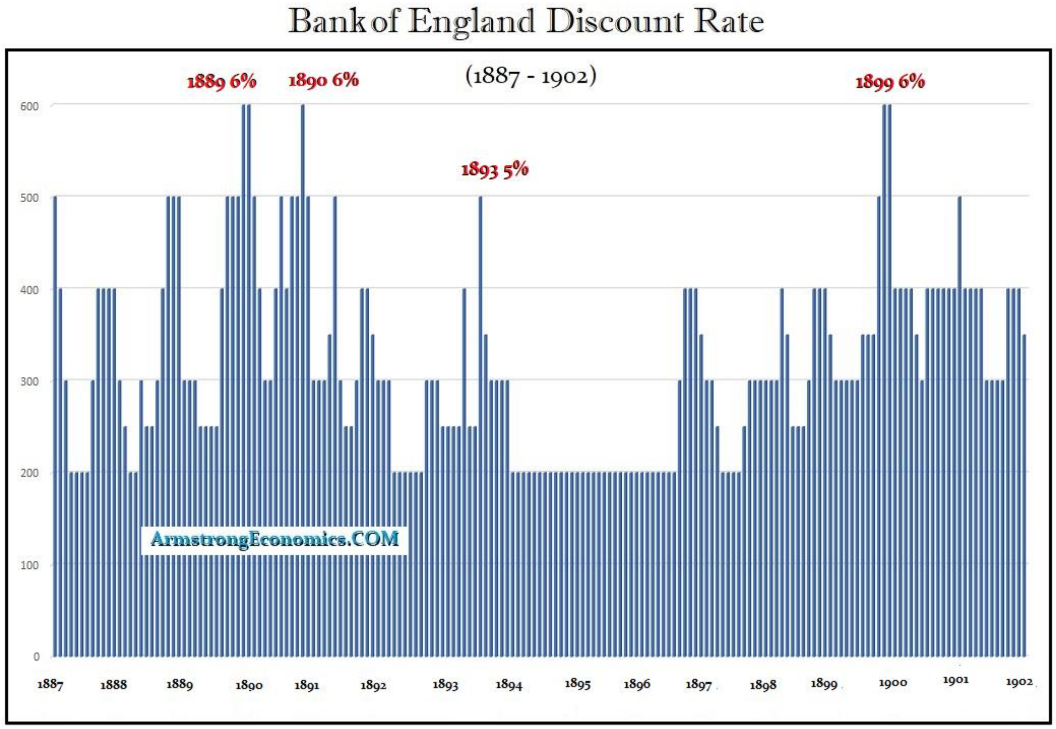
The austerity philosophy imposed upon Europe as the price for German agreement to join the euro has been devastating. It has been attempted many times throughout history, such as Tiberius who set off the Financial Panic of 33 AD. Again, nobody ever asks the simple question: "Has this been attempted before?"

Panic of 1899

In 1899, the Dow Jones Industrial Average rallied in the final three years of the century from the Panic low of 1896 following the major high of 1889. Commentators saw reasons for the gains as globalization, technological improvements in electricity and telephone communication, medical discoveries, and the move to a market economy. Yes, this was seen as the globalization of financial markets even back in 1899.

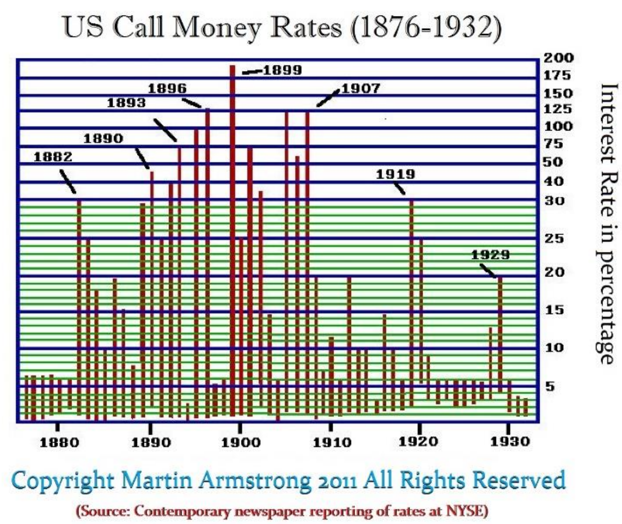
The Dow Industrials shot to record highs as road, metal, and communication companies merged and investments poured into new enterprises and booming technologies. Million-share days became common on the exchange as it was the 19th century takeover boom. This attraction of investment opportunities in America was not unlike the boom of 1720 with the South Sea and Mississippi Bubbles.

Nevertheless, the price of globalization has been the clash with domestic economic policies. We have laws that prohibit foreign buying of real estate in places like Thailand because of the 1997 Asian Currency Crisis. We have laws imposed on foreign buyers of real estate post-2007 in Britain, Canada, Australia, and New Zealand. Capital has been fleeing Europe and China seeking tangible property primarily in the Anglo-Saxon world economies. This is all part of globalization and the failure of politicians to understand the driving causes behind such capital movements.



In 1899, the Bank of England doubled its discount rate to 6% in November 1899, up from 3% in February 1899, to curb excessive strength in the domestic economy due to fears of speculative inflation. A full-scale panic unfolded in Britain setting off a global contagion as British investors sold American assets to cover losses back home. The US Call Money rate on the New York Stock Exchange touched 200%, forming the all-time historical high on December 18, 1899.

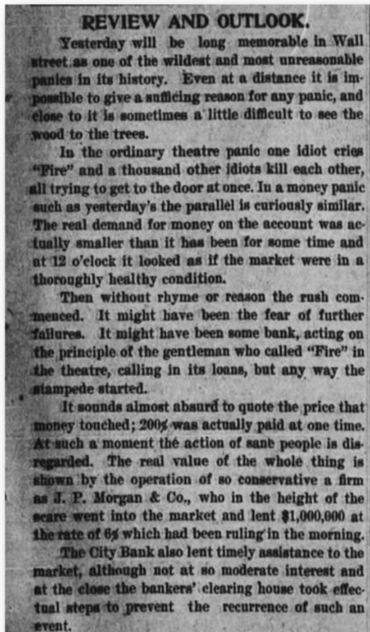
The panic began the week of December 4, 1899, as the Dow Jones Industrials opened below the previous week's low and collapsed from 53.89. It bottomed the following week at 42.68, which was a 20% drop in just two weeks. The primary selling took place in the industrials as it was seen as the technology boom similar to the Dot.com Bubble of 2000.



MORNING EDITION. THE WALL STREET JOURNAL. MORNING EDITION.

Vol. XVII.—New Series Vol. XI.—No. 134. NEW YORK, TUESDAY MORNING, DECEMBER 19, 1899. PRICE THREE CENTS.

Call Money Rates hit 200%, Monday, December 18th, 1899 & House Passes Gold Standard Currency Bill



REVIEW AND OUTLOOK.

Yesterday will be long memorable in Wall street as one of the wildest and most unreasonable panics in its history. Even at a distance it is impossible to give a sufficing reason for any panic, and close to it is sometimes a little difficult to see the wood to the trees.

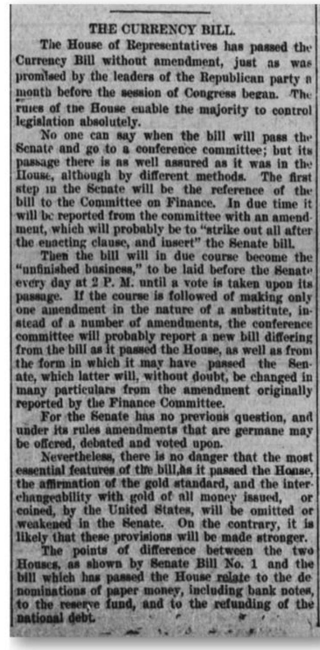
In the ordinary theatre panic one idiot cries "Fire" and a thousand other idiots kill each other, all trying to get to the door at once. In a money panic such as yesterday's the parallel is curiously similar. The real demand for money on the account was actually smaller than it has been for some time and at 12 o'clock it looked as if the market were in a thoroughly healthy condition.

Then without rhyme or reason the rush commenced. It might have been the fear of further failures. It might have been some bank, acting on the principle of the gentleman who called "Fire" in the theatre, calling in its loans, but any way the stampede started.

It sounds almost absurd to quote the price that money touched; 200% was actually paid at one time. At such a moment the action of sane people is disregarded. The real value of the whole thing is shown by the operation of so conservative a firm as J. P. Morgan & Co., who in the height of the scare went into the market and lent $1,000,000 at the rate of 6% which had been ruling in the morning.

The City Bank also lent timely assistance to the market, although not at so moderate interest and at the close the bankers' clearing house took effectual steps to prevent the recurrence of such an event.

The Wall Street Journal, Dec 19th, 1899
Tuesday • Page 1



THE CURRENCY BILL.

The House of Representatives has passed the Currency Bill without amendment, just as was promised by the leaders of the Republican party a month before the session of Congress began. The rules of the House enable the majority to control legislation absolutely.

No one can say when the bill will pass the Senate and go to a conference committee; but its passage there is as well assured as it was in the House, although by different methods. The first step in the Senate will be the reference of the bill to the Committee on Finance. In due time it will be reported from the committee with an amendment, which will probably be to "strike out all after the enacting clause, and insert" the Senate bill.

Then the bill will in due course become the "unfinished business," to be laid before the Senate every day at 2 P. M. until a vote is taken upon its passage. If the course is followed of making only one amendment in the nature of a substitute, instead of a number of amendments, the conference committee will probably report a new bill differing from the bill as it passed the House, as well as from the form in which it may have passed the Senate, which latter will, without doubt, be changed in many particulars from the amendment originally reported by the Finance Committee.

For the Senate has no previous question, and under its rules amendments that are germane may be offered, debated and voted upon.

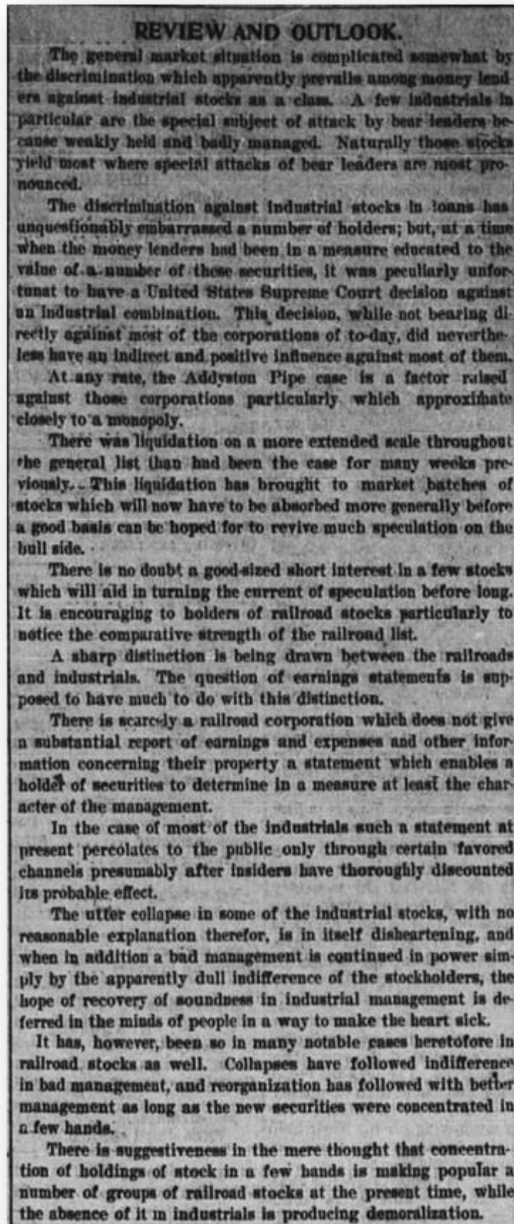
Nevertheless, there is no danger that the most essential features of the bill, as it passed the House, the affirmation of the gold standard, and the interchangeability with gold of all money issued, or coined, by the United States, will be omitted or weakened in the Senate. On the contrary, it is likely that these provisions will be made stronger.

The points of difference between the two Houses, as shown by Senate Bill No. 1 and the bill which has passed the House relate to the denominations of paper money, including bank notes, to the reserve fund, and to the refunding of the national debt.

The Wall Street Journal (WSJ) reported that there was wholesale discrimination against industrials stocks. They implied that this was one of the most absurd declines in history. They wrote concerning the price action of December 18: "Yesterday will be long memorable in Wall street as one of the wildest and most unreasonable panics in its history." Referring to the interest rates, the WSJ reported: "It sounds almost absurd to quote the price that money touched; 200% was actually paid at one time. At such a moment the action of sane people is disregarded." That very same day, WSJ reported that the House passed the "currency bill" returning the United States to a gold standard, which was signed March 14. Even the London Underground's Central London Railway opened in June that year. The next month, the first zeppelin flight took place in Germany.

The Panic of 1899 was not entirely without reason. The panic began the week of December 4, 1899, as the bulls turned into a stampede following the Supreme Court decision concerning a merger involving Addyston Pipe. The Court upheld the Rule of Reason doctrine regarding U.S. antitrust laws in Addyston Pipe and Steel

Co. v. United States, 175 U.S. 211 (1899). This was a United States Supreme Court case in which the court held that for a restraint of trade to be lawful, it must be ancillary to the main purpose of a lawful contract.



REVIEW AND OUTLOOK.

The general market situation is complicated somewhat by the discrimination which apparently prevails among money lenders against industrial stocks as a class. A few industrials in particular are the special subject of attack by bear leaders because weakly held and badly managed. Naturally those stocks yield most where special attacks of bear leaders are most pronounced.

The discrimination against industrial stocks in loans has unquestionably embarrassed a number of holders; but, at a time when the money lenders had been in a measure educated to the value of a number of these securities, it was peculiarly unfortunat to have a United States Supreme Court decision against an industrial combination. This decision, while not bearing directly against most of the corporations of to-day, did nevertheless have an indirect and positive influence against most of them.

At any rate, the Addyston Pipe case is a factor raised against those corporations particularly which approximate closely to a monopoly.

There was liquidation on a more extended scale throughout the general list than had been the case for many weeks previously. This liquidation has brought to market batches of stocks which will now have to be absorbed more generally before a good basis can be hoped for to revive much speculation on the bull side.

There is no doubt a good-sized short interest in a few stocks which will aid in turning the current of speculation before long. It is encouraging to holders of railroad stocks particularly to notice the comparative strength of the railroad list.

A sharp distinction is being drawn between the railroads and industrials. The question of earnings statements is supposed to have much to do with this distinction.

There is scarcely a railroad corporation which does not give a substantial report of earnings and expenses and other information concerning their property a statement which enables a holder of securities to determine in a measure at least the character of the management.

In the case of most of the industrials such a statement at present percolates to the public only through certain favored channels presumably after insiders have thoroughly discounted its probable effect.

The utter collapse in some of the industrial stocks, with no reasonable explanation therefor, is in itself disheartening, and when in addition a bad management is continued in power simply by the apparently dull indifference of the stockholders, the hope of recovery of soundness in industrial management is deferred in the minds of people in a way to make the heart sick.

It has, however, been so in many notable cases heretofore in railroad stocks as well. Collapses have followed indifference in bad management, and reorganization has followed with better management as long as the new securities were concentrated in a few hands.

There is suggestiveness in the mere thought that concentration of holdings of stock in a few hands is making popular a number of groups of railroad stocks at the present time, while the absence of it in industrials is producing demoralization.

The Wall Street Journal
December 9th 1899, Sat • Page 1

The Supreme Court held that Congress was granted power under Section 8 of Article I of the Constitution "to regulate commerce with foreign nations and among the several states and with Indian tribes." Therefore, they may enact such legislation and shall declare void and prohibit the performance of any contract between individuals or corporations where the natural and direct effect of such a contract shall be, when carried out, and not as a mere incident to other and innocent purposes, regulate to any extent interstate or foreign commerce.

That decision in Addyston Pipe and Steel Co. was seen as highly discretionary and dangerous to the economic boom that had been underway since 1896. This is why the WSJ reported that there was discrimination against industrial shares. Suddenly, the takeover boom of the 19th century was seen as high–risk when mergers were in the hands of bureaucrats who were becoming highly socialistic and anti–free market.

Panhard et Levassor (1899)

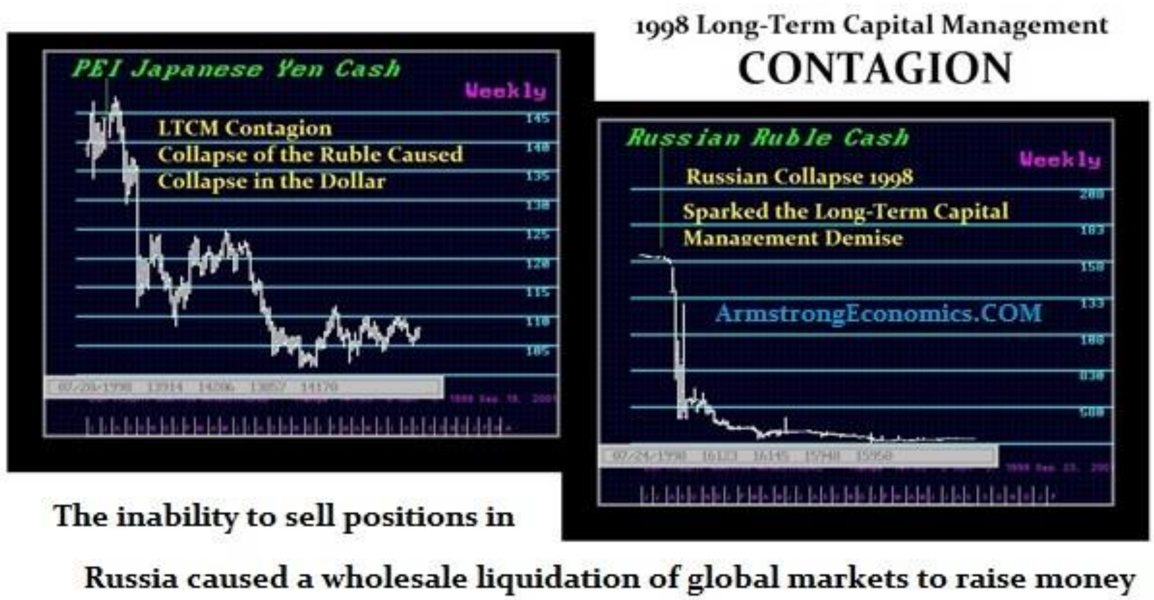
This was also the dawn of the automobile. The first company formed exclusively to build automobiles was Panhard et Levassor in France in 1889, which also introduced the first four–cylinder engine. Panhard was quickly followed by Peugeot two years later. By the early 1900s, the automobile industry was beginning to take off in Western Europe, especially in France where 30,204 vehicles were produced in 1903, representing just shy of 50% of total world automobile production that year.

The Wall Street Journal, recounting the days leading up to the Panic of 1899/1900, also reported the collapse of a bubble in copper stocks, bank bailouts in Boston, and a disastrous geopolitical British setback against the Boers in South Africa from the cycle of war perspective.

As 1900 came a few weeks later, the bounce was marginal with the Dow reaching 5007. It then turned down once again and finally made its low the week of September 23, 1900, at 3879.

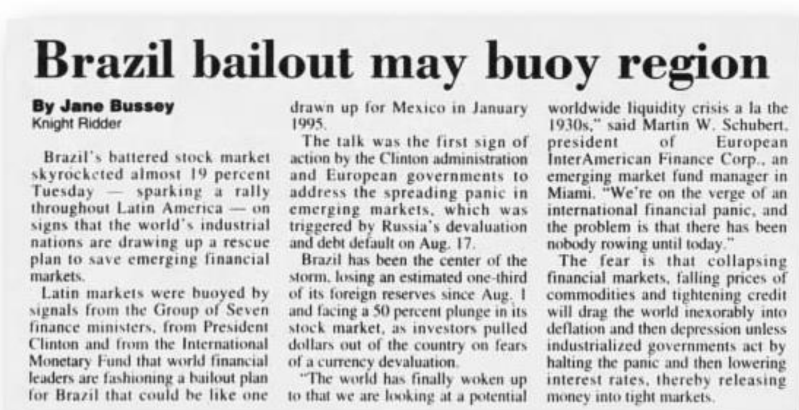
Besides the Antitrust legislation, there was a continued rise in union activity around the globe that frightened capital investment. On January 4, 1900, there were strikes in Belgium and Germany that led to major mining riots. Later that same month on the 23rd, about 5,000 Austrian miners went on strike.

On the political side, both in Europe and Australia the climate was turning much more socialistic. On February 27, 1900, the British Labour Party was officially established with Ramsay MacDonald as its first secretary. By September 25th, the British general election saw the Labour Party win two seats. On March 31, 1900, France legislated that the length of a legal workday for women and children was limited to 11 hours. On July 29, 1900, King Umberto I of Italy was assassinated by Italian–born anarchist Gaetano Bresci in Monza.



As was the case in 1899, there was the liquidity crisis of 1998 after the collapse in Russian bonds took place. Investors, including Long–Term Capital Management, were forced to sell assets everywhere else to raise money to cover losses stemming from Russia. The dollar crashed against the Japanese yen simply because they needed money. It had nothing to do with the Japanese economy.

Indeed, the investment boom in emerging markets came to a sudden end with the collapse in the Russian bond markets. There was a massive liquidity crisis that sparked a worldwide contagion of mass liquidation.



Brazil bailout may buoy region

By Jane Bussey
Knight Ridder

Brazil's battered stock market skyrocketed almost 19 percent Tuesday — sparking a rally throughout Latin America — on signs that the world's industrial nations are drawing up a rescue plan to save emerging financial markets.

Latin markets were buoyed by signals from the Group of Seven finance ministers, from President Clinton and from the International Monetary Fund that world financial leaders are fashioning a bailout plan for Brazil that could be like one drawn up for Mexico in January 1995.

The talk was the first sign of action by the Clinton administration and European governments to address the spreading panic in emerging markets, which was triggered by Russia's devaluation and debt default on Aug. 17.

Brazil has been the center of the storm, losing an estimated one-third of its foreign reserves since Aug. 1 and facing a 50 percent plunge in its stock market, as investors pulled dollars out of the country on fears of a currency devaluation.

"The world has finally woken up to that we are looking at a potential worldwide liquidity crisis a la the 1930s," said Martin W. Schubert, president of European InterAmerican Finance Corp., an emerging market fund manager in Miami. "We're on the verge of an international financial panic, and the problem is that there has been nobody rowing until today."

The fear is that collapsing financial markets, falling prices of commodities and tightening credit will drag the world inexorably into deflation and then depression unless industrialized governments act by halting the panic and then lowering interest rates, thereby releasing money into tight markets.

The Post-Star Glens Falls, New York September 16, 1998, Page 18

All economic theories presented post–Marx have been based upon a fundamental assumption that this global complexity does not even exist. Worse, these theories argue the economic driver can be reduced to a single cause and effect that is usually a domestic event. That basic assumption has colored all economic theories that have emerged post-Marx and his publication of the *Communist Manifesto* published in 1848. Ever since Marx, most economic theories have adopted the proposition that government is capable of manipulating the domestic economy. Yet, these theories fail inevitably as they cannot control external factors from global contagions.

There has been no theory to date that has been employed by governments to prevent an economic recession. As Larry Summers wrote in the *Washington Post* back on December 6, 2015, "[S]ince World War II, no postwar recession has been predicted a year in advance by the Fed, the White House or the consensus forecast."

The simple reason why economists cannot forecast major events is due to the fact that they have yet to discover the global economy and how it functions.

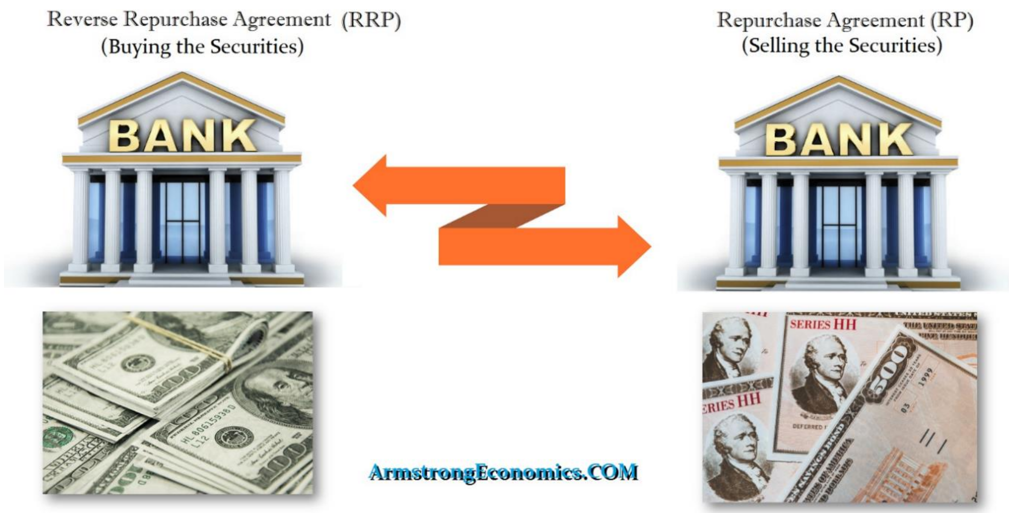
Understanding the Repo Crisis

To understand the Repo Crisis, we must first open our minds and understand that global economic contagions have been the primary influence that has driven the world economy for centuries. We will never come to comprehend what the Repo Crisis is all about unless we look beyond the simplistic domestic analysis that dominates all the chatter.

The worst of the analysis out there comes from the gold promoters who only see the world through the eyes of gold. Yet, they know nothing about monetary history and even less about how the monetary system has collapsed historically. All such monetary systems die much like a human body. The extremities are the first to grow cold and then it moves into the center where the heart finally stops. The peripheral economies are where you will always see the first signs of a terminal illness. Capital withdraws from the outer lying economies and contracts back into the financial capital of the world at that moment. As the peripheral economies go into crisis from a lack of capital, defaults begin to spread like a contagion. Panic typically sets in and then spreads, ultimately inflicting the core economy.

The gold promoters always predict doom and gloom and argue that it's not terribly difficult to predict what's going to happen next all based upon the Quantity Theory of Money. They argue that the Federal Reserve will drop the secrecy and start buying US debt openly, presuming that this Repo Crisis is simply a domestic cover-up for a new round of Quantitative Easing. This mere statement proves they completely lack any understanding of this crisis. The gold promoters still argue that

US fiscal deficits are exploding, and foreign buyers are heading for the exits as if other nations are in better shape and the sovereign debt crisis is exclusive to the United States. This is a plain opinion and they have no understanding of the Repo market or the world economy and the scope of government debt globally.



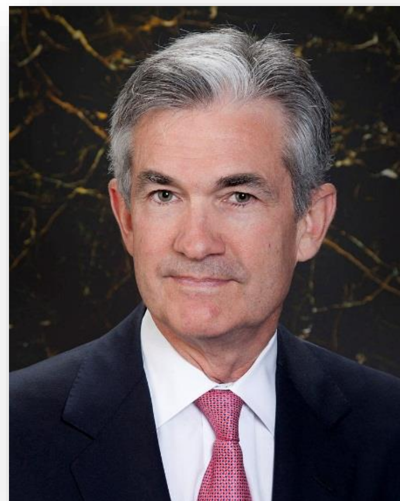
The gold promoters theorize that since the Fed cannot buy debt directly from the Treasury, and only from the secondary market, the Repo Crisis is all about the Fed attempting to buy US debt indirectly to hide what they are doing. This makes no sense whatsoever. They clearly fail to understand that the repo market is the repurchase market. If an institution needs cash overnight, that is where it can post its AAA debt holdings to borrow cash for that night only. The Fed is providing $120 billion daily, which does not mean it is pouring cash into the market amounting to $120 billion every day on an accumulative basis or $1.2 trillion in 10 days. This is like a line of credit that maxes out each day.

The gold promoters wrongly assume that the Fed is trying to buy government debt through the repo market because it can only legally buy government debt indirectly in the open market. Obviously, they presume, if the Fed purchased government debt directly from the Treasury, it would be viewed that this would jeopardize their independence. Hence, its authority is restricted to purchase government debt only from the open market and not directly from the Treasury. They claim that this not really what's going on:

> "[I]t's now clear that something spooked the Fed badly in September. We still don't know what exactly went on, but the Repo Market blew up. While this was a clear sign that something big was amiss, the Fed has not yet explained what the cause was, who needed to be bailed out, or why."

The basic assumption here is based purely on a domestic perspective. They further argue that the Fed is refusing to explain why they are intervening to provide liquidity in the repo market, and they have characterized it as Quantitative Easing and Modern Monetary Theory all predicated upon the presumption that the Quantity Theory of Money actually works.

While Fed Chairman Jerome Powell stated publicly that their intervention into the repo market is not QE, the gold promoters simply attribute this to systemic lies. They even argue that if the Fed is accepting bills that were issued the same day, they are acting clandestinely and buying government debt virtually directly. They overlook that this is the repo market for a single night. Banks keep cash in US T-Bills, and they post them to raise cash on a daily basis when they need it. This is not some plot for the Fed to buy government debt clandestinely when in fact US debt is being hoarded globally in contrast to negative interest rates in the euro, which have unseated the euro as a reserve currency even among central banks.



This latest conspiracy theory has misled so many that one must ask whether these people are actually analysts or if they are deliberately spreading propaganda to support the government to hide the true events taking place. Their inability to provide objective authoritative analysis is very questionable with regard to their stupidity and/or independence.

Pretend analysts who are blind to the world as a whole keeps the true Repo Crisis shrouded in confusion. They are unable to understand what is taking place and neither the governments nor the mainstream media will dare to cover the story out of fear that it will expose the real crisis unfolding — the collapse in confidence in government itself.

Repo – A Global Crisis

The conspiracy theories regarding the Repo Crisis are pointing the finger domestically. They are either deliberately trying to assist the government in maintaining its closed-mouth policy with regard to what is truly going on or they are simply sublime idiots incapable of understanding the interconnected world. To understand the Repo Crisis, we must understand international banking and the interconnected global economy.

The global economy has been interconnected since ancient days. As discussed with the Financial Panic of 33 AD, Emperor Tiberius (14–37 AD) sought to stop the land speculation in the provinces that were the emerging markets of the day. As Rome conquered various regions, they were assimilated into the Roman Empire, which greatly benefited from them for their economies boomed. They were able to produce various local products or agriculture and found a global marketplace within the entire empire. Grain, for example, was routinely imported from Egypt, which became the breadbasket for Rome much as the Midwest in the United States feeds more than just the people in the United States.

Even going back to ancient Athens, they issued a silver decadrachm that was similar to a $1,000 bill. The coin was far too large a denomination for domestic commerce. It was used for large transactions in international commerce. How do we know that? Specimens that have been discovered are all around the Mediterranean Sea but not in Athens. But this practice of what amounts to a two-tier currency system has prevailed throughout the centuries. The gold coin issued by Florence, known as the Florin, was also used only in international transactions with silver coins providing the local currency.

What we face today is an international contagion that can become the Mother of All Financial Panics in history. This is by no means emanating from the United States. It is brewing in Europe as a result of a structural flaw in the design of the euro. This presents a risk for a major political crisis in Europe if the EU government tries to intervene, assuming they even understand what is unfolding.

The reason this crisis presents such a threat globally is due to the policies in the European Union that prohibit bank bailouts. Since their tentacles stretch around the globe, this threatens to bring down the global economy and is most likely the prelude to the coming Monetary Crisis Cycle.

When the 2007–2009 Financial Crisis unfolded, the US bailed out the banks by buying the toxic waste from the banks, thereby cleaning up their books and preventing a massive collapse of the world banking system. With Europe vowing not to bail out banks and imposing only bail-ins, this means that the losses from a counterparty risk will be exported from Europe around the world. Consequently, the banks no longer trust banks because nobody understands the risks. Hence, the Fed has had to step in since September 17, 2019, to be the counterparty in the repo market as banks refuse to deal with other banks.

The German Austerity – The Root of the Crisis

The entire economic structural design behind the creation of the euro was dictated by German Chancellor Helmut Kohl (1930–2017). Without the German participation, there would never have been the creation of the euro. Unfortunately, Germany has been prejudiced by its misconception of history. Germany has never understood the cause of its hyperinflation of the 1920s. Germany imposed its philosophy of austerity upon the rest of Europe, which became the cornerstone of the Eurozone.

This central issue behind the Repo Crisis is the structural design flaw of euro, which was based on former Chancellor Kohl's demands in order for Germany to agree to join the single currency. Today, Germany's austerity philosophy is tearing the EU and the Eurozone apart. Germany's austerity philosophy is rooted in their misunderstanding of the Quantity Theory of Money.

Helmut Kohl
(1930 – 2017)
ArmstrongEconomics.COM

Helmut Kohl admitted before he died that he acted like a "dictator" to bring in the single currency to the country, otherwise he "would have lost" had he held a referendum (see Telegraph; 09 Apr 2013).

Kohl was Germany's longest-serving postwar chancellor. To force the euro on all of Europe, he had to act like a dictator and deny any democratic vote. He would have lost any such popular vote on the euro by an overwhelming majority had he held a vote.

> "I knew that I could never win a referendum in Germany," he said. "We would have lost a referendum on the introduction of the Euro. That's quite clear. I would have lost and by seven to three."

Adopting the euro was an emblem of the European project to Kohl. He said the currency would prevent war on the continent. He further explained:

> "If a Chancellor is trying to push something through, he must be a man of power. And if he's smart, he knows when the time is ripe. In one case – the Euro – I was like a dictator ... The Euro is a synonym for Europe. Europe, for the first time, has no more war."

Indeed, the European Central Bank (ECB) was sued in the European high court by its German opponents over Quantitative Easing (loose monetary policy), arguing the legality of a 2012 sovereign bond-buying program. The European Union treaty prohibited the direct financing of national governments by the ECB. The plaintiffs alleged that the pledge to buy large quantities of sovereign bonds was in violation of the treaty. From a true legal perspective, they were correct. However, for political reasons, the court could never rule against the government.

ERM CRISIS

Germany's austerity philosophy predates the euro. German Bundesbank had opposed any currency devaluation of the lira back in 1992. They ultimately forced Italy to withdraw from the European Exchange Rate Mechanism (ERM), as was the case with the British pound's exit on September 16, 1992, in what became known as Black Wednesday. Some, such as the British politician Norman Tebbit, called the ERM that was being dictated by Germany the "Eternal Recession Mechanism" even back then.

During the 1992 ERM Crisis, the governor of the central bank of Italy, Banca d'Italia, Carlo Azeglio Ciampi, was notified in what became known as the famous Emminger letter from Bundesbank. President Otmar Emminger of the bank informed Italy that the Bundesbank would not continue to intervene in support of the Italian lira. Ironically, Mario Draghi was the director of the Italian Treasury back then and had supported a devaluation. Consequently, Germany rejected any devaluations, which compelled Italy and Britain to withdraw from the ERM. Germany's rejection of any devaluations in the ERM was the staging ground for the euro. This is also the reason for rejecting any cross-border flows of funds and debt consolidation.

Nevertheless, the Quantitative Easing (QE) by the ECB has challenged the German austerity philosophy. The QE has prevented the Eurozone from breaking apart during this economic crisis that began in 2008 and moved to negative interest rates by 2014. The Bundesbank realizes that without QE, the euro would have failed.

Questions referred to High Court

Does Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), [1] as amended by Decision (EU) 2015/2101 of the European Central Bank of 5 November 2015 amending Decision (EU) 2015/774 on a secondary markets public sector asset purchase programme (ECB/2015/33), [2] Decision (EU) 2016/702 of the European Central Bank of 18 April 2016 amending Decision (EU) 2015/774 on a secondary markets public sector asset purchase programme (ECB/2016/8) [3] and Decision (EU) 2016/1041 of the European Central Bank of 22 June 2016 on the eligibility of marketable debt instruments issued or fully guaranteed by the Hellenic Republic and repealing Decision (EU) 2015/300 (ECB/2016/18), [4] or the method of its implementation, infringe Article 123(1) of the Treaty on the Functioning of the European Union?

Does it infringe Article 123(1) of the Treaty on the Functioning of the European Union in particular if in the course of the public sector asset purchase programme (PSPP)

a) details of the purchases are communicated in a way that creates de facto certainty on the markets that the Eurosystem will purchase part of the bonds to be issued by the Member States?

b) even after the event no details are given about compliance with minimum periods between the issue of a debt instrument on the primary market and its purchase on the secondary market, with the result that a review by the courts is not possible in that regard?

c) all bonds purchased are not resold but held until maturity and thus withdrawn from the market?

d) the Eurosystem purchases marketable debt instruments with a negative yield at maturity?

Does the Decision referred to in 1 above then infringe Article 123 TFEU in any event if, in view of changes in conditions on the finance markets, in particular as a result of a shortage of bonds available for purchase, its continued implementation requires a continual loosening of the originally agreed purchase rules and the restrictions laid down in the case-law of the Court of Justice for a bond purchase programme, such as the PSPP represents, lose their effect?

Does the current version of Decision (EU) 2015/774 of the European Central Bank of 4 March 2015, referred to in 1 above, infringe Article 119 and Article 127(1) and (2) of the Treaty on the Functioning of the European Union and Articles 17 to 24 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank because it exceeds the monetary policy mandate of the European Central Bank laid down in those provisions and for that reason encroaches upon the competence of the Member States?

Is the mandate of the European Central Bank exceeded in particular as a result of the fact that

a) on the basis of the volume of the PSPP, which amounted to EUR 1 534.8 billion on 12 May 2017, the Decision referred to in 1 above materially influences the refinancing terms of the Member States?

b) in view of the improvement in the refinancing terms of the Member States referred to in (a) above and their effect on the commercial banks, the Decision referred to in 1 above has not only indirect economic policy consequences but its objectively ascertainable effects suggest that an economic policy aim of the programme is at least of equal priority as the monetary policy aim?

c) on account of its powerful economic policy effects, the Decision referred to in 1 above infringes the principle of proportionality?

d) in the absence of a specific statement of reasons during the period of more than two years of implementation, it is not possible to examine whether the Decision referred to in 1 above is still necessary and proportionate?

Does the Decision referred to in 1 above infringe Article 119 and Article 127(1) and (2) TFEU and Articles 17 to 24 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank in any event because its volume and implementation period of more than two years and the resulting economic policy effects give grounds for a different view of the need for and proportionality of the PSPP and consequently, from a certain point in time, it exceeds the economic policy mandate of the European Central Bank?

Does the unlimited sharing of risks between the national central banks of the Eurosystem that may be provided for under the Decision referred to in 1 above, in the event of the non-repayment of bonds of the central governments and of equivalent issuers, infringe Article 123 and Article 125 of the Treaty on the Functioning of the European Union and Article 4(2) of the Treaty on European Union, if as a result it may be necessary for national central banks to be recapitalised using budget funds?

Indeed, former ECB President Mario Draghi said at the time that the ECB would do "whatever it takes" to save the Eurozone. Make no mistake about it, the ECB has kept the Eurozone member states on life support but now it is trapped and cannot escape this dilemma.

The European high court ruled that the ECB's bond purchasing program was in line with the law. The ECB President Mario Draghi clashed with a ban on so-called monetary financing. The Court ruled: "It does not exceed the ECB's mandate and does not contravene the prohibition of monetary financing."

A second suit was filed where the German judges asked the EU top court's guidance on a challenge to the ECB's Outright Monetary Transactions (OMT) program. The German tribunal reluctantly followed that direction in its final judgment.

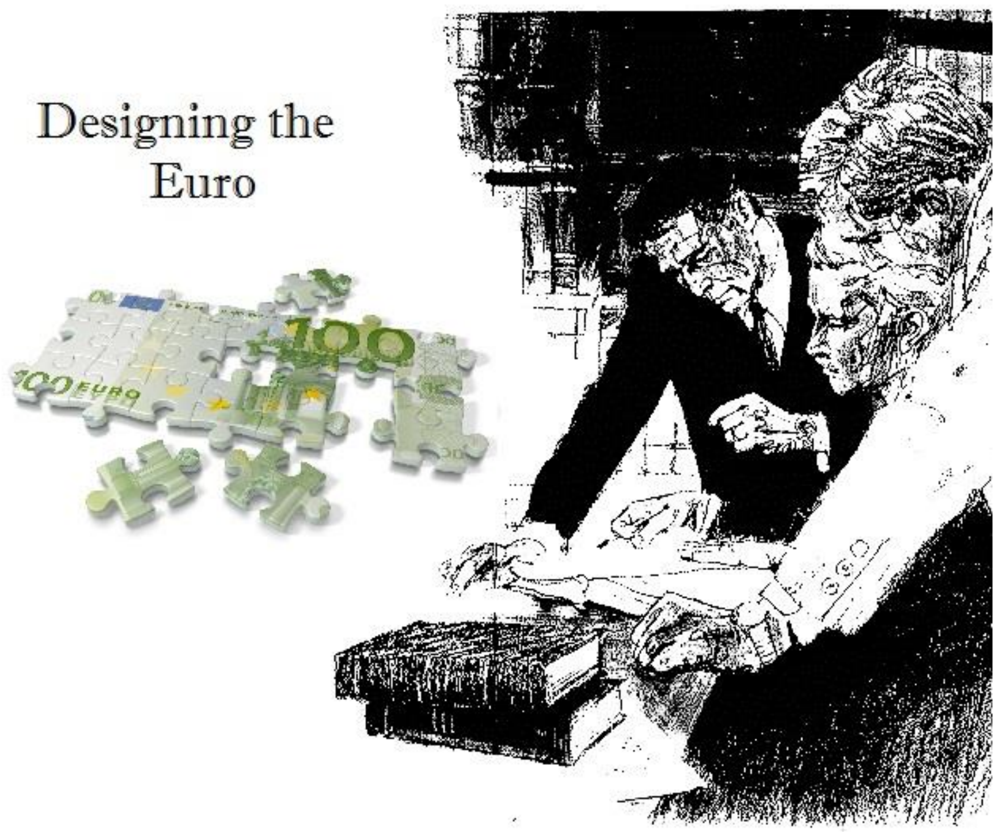
Quantitative easing is different from OMT, which was announced in 2012 but never used. In the case of OMT, the ECB can start buying government bonds from a eurozone member state only after the country turns for financial assistance and meets its conditions much like the IMF. The Federal Reserve in the USA has no such power nor responsibility to intervene concerning the debt of any of the 50 states. The difference here stems from the structural flaw in the Eurozone and the failure to consolidate the debts initially. Thereafter, each state would have been on its own.

The Karlsruhe, a Germany-based tribunal, decided that there are "grave reasons to hold that the motions underlying the bond-buying program violate the ban on monetary financing of states and overstep the mandate of the European Central Bank and thus transgress the powers of the member states."

Politically, the European high court simply had to rule in favor of the ECB or there would have been an economic crisis that would have torn the EU completely apart. The treaty unquestionably outlawed the ECB from engaging in financing the member states. The high court Ruled:

"Against that background the Advocate General notes that the aim of achieving inflation rates below, but close to, 2% over the medium term is in reach. That is why the ECB stated, during the meeting of the Governing Council of 14 June 2018, that the monthly pace of the net asset purchases under the APP would, in principle, be reduced to €15 billion from October 2018 until the end of December 2018 and that net purchases will then end.

In the third place, the Advocate general considers, as regards the proportionality of the PSPP, that the PSPP is as capable of attaining its objective as is necessary (because the ECB had already exhausted the other monetary policy measures that are equally effective) and does not go manifestly beyond what is necessary. The ESCB sufficiently weighed up the various interests involved in such a way as to prevent disadvantages which are manifestly disproportionate to the objectives pursued from arising when the PSPP is implemented."



The ECB's new bond-buying program was expanded beyond sovereign bond purchases which were not part of the treaty, so it was not formally prohibited. The failure of the ECB to create inflation has led to the rising solution known as the Modern Monetary Theory (MMT), whereby the argument is that we can just print money with no consequences. The inability of the ECB to create inflation has been used in support of MMT while it has called into question the validity of the Quantity Theory of Money (QTM) and thus Germany's austerity philosophy.

At the core of creating the Eurozone was this belief in a one-world government in Europe. We have repeatedly heard this reasoning for creating the Eurozone. The federalization of Europe was to prevent another European war. To sell the euro, they used the false promises of savings in currency exchange rates and said everyone would enjoy the same interest rate. The interest rate promise never materialized. On top of that, this European project to federalize Europe is causing old resentments to surface once again.

Kohl lost the election in September 1998. The economic crisis in the wake of the collapse of Lehman Brothers and the German reunification led to the doubling of unemployment in Germany. Additionally, there was Germany's tax and welfare reforms. While the CDU/CSU had offered proposals to reduce benefits in healthcare and pensions, the SPD controlled Bundesrat. While Kohl continually pushed the issue of European integration, the issue fell short from voters' minds. The SPD, on the other hand, almost ignored the issue entirely. Many voters in Germany simply had other concerns besides the European Union and the covert plot to federalize Europe behind their backs.


The Maastricht Treaty that was signed on February 7th, 1992

Kohl's major political achievement was the signing of the Maastricht Treaty on February 7, 1992, just a few months before the ERM Crisis. This was the event that brought the European Union into existence and paved the way for the creation of the euro currency. It was British Prime Minister John Major, not Margaret Thatcher, who signed for Britain.

Whatever else they may have done, the EU and the euro (replacing the former, less politically integrated European Economic Community) gave Germany the markets and the means to produce a second German industrial and manufacturing miracle. By eliminating all the currencies within Europe, Kohl understood that this would eliminate foreign exchange risk and create the major German economic dominance of Europe.

Helmut Kohl
(1930 – 2017)
Chancellor of Germany (1982 – 1998)

The Berlin Wall fell in 1989, the German reunification/unity (German: Deutsche Einheit) took place on October 3, 1990, and federalizing Europe was the next objective. In truth, Margaret Thatcher opposed the reunification on the grounds that she feared German industrial skills would dominate Europe. Nevertheless, when the Berlin Wall fell, Angela Merkel ran for office as the first woman from East Germany. Kohl himself added her as a symbol of unification to his cabinet.

The German reunification and the signing of the Maastricht Treaty had one major side-effect. Germany had indeed the largest economy within Europe. However, it also was living in the past with respect to the misinterpretation of its economic history. There are signs of great stress emerging even within Germany over this misinterpretation of the hyperinflation period and the imposition of austerity philosophy.

Indeed, the same austerity philosophy once dominated the United States pre-Great Depression, which was reinforced by the view of the German and Austrian hyperinflations of the 1920s. When Franklin Roosevelt (President 1933–1945) came to power following the 1932 election, he created what became known as his Brains Trust. They were dead set on maintaining austerity under the assumption that the outstanding bond holders would lose confidence if the government increased the money supply in times of economic stress. Therefore, the theory was all about government maintaining its credit rating because it borrowed. It had nothing to do with the welfare of people.

The original concept of a Brains Trust was a group of academic advisers that President Woodrow Wilson formed in 1917 to prepare for the peace negotiations following World War I. It was on September 6, 1932, when it was reported that Roosevelt's "brains department" was helping him create policy positions and make speeches. The *Times* on September 9, 1932, called this same group a "Brains Trust." Newspapers began to call it a "Brain Trust" by at least October 17, 1932.

Franklin D. Roosevelt's 1933 Brains Trust

Adolf Berle (1895–1971) **Raymond Moley** (1886-1975) **Rexford Tugwell** (1891–1979)

The core of the first Roosevelt Brains Trust consisted of a group of Columbia law professors Adolf Berle (1895–1971), Raymond Moley (1886–1975), and Rexford Tugwell (1891–1979). Note that they were lawyers, not market investors, technicians, or economists. They knew how to get around the Constitution, not how to straighten out the economy. They were lawyers who were not versed in economic theory.

The Second Roosevelt Brains Trust emerged from men associated with the competing Harvard law school. It included Benjamin V. Cohen (1894–1983), Thomas Gardiner Corcoran (1900–1981), and Felix Frankfurter (1882–1965) who became a Supreme Court Justice although he was born in Vienna. These men played a key role in shaping the policies of the Second New Deal

(1935–1936). There was also Hugh Samuel "Iron Pants" Johnson (1881–1942) who graduated West Point and went on to get his law degree from Berkeley University in 1916.

None of the members of Roosevelt's Brains Trust were experienced in economics. Most were simply lawyers trying to get around the Constitution. Moley broke away in disagreement with Roosevelt and became a sharp critic of the New Deal. They all articulated the same austerity philosophy that has dominated Europe since the establishment of the Eurozone.

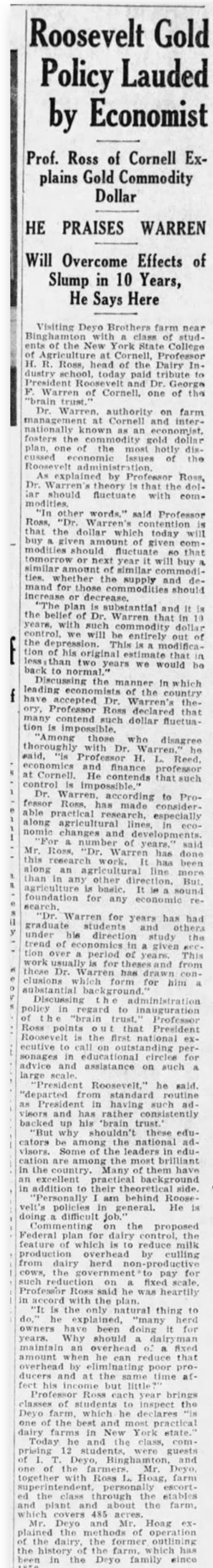
George F. Warren (1874-1938)

George Warren (1874–1938) was the farmer–economist outside of the then mainstream economic austerity philosophy whose idea was to devalue the dollar. The Brains Trust totally disagreed and they had nothing to do with the devaluation of the dollar. They disliked Warren and viewed his ideas as dangerous.

In 1932, George Warren had written, "Wholesale Prices for 213 Years; 1720–1932." Effectively, this work was a forerunner to Monetary Theory by making observations that prices rose with the gold discoveries and declined when supplies of gold declined. This work was a simplistic monetary view of the world that Franklin Roosevelt could understand.

Warren observed that money was really just a medium of exchange. As its value rises, wages and assets decline in value as expressed in that currency. Consequently, maintaining the gold standard, as Germany insists upon austerity today, created deflation as prices collapsed and gold became scarce after rising in value.

Warren's observation thus became a simple relationship. The only way to raise prices and end the deflation of the Great Depression, Warren believed, was to raise the price of gold,



Roosevelt Gold Policy Lauded by Economist

Prof. Ross of Cornell Explains Gold Commodity Dollar

HE PRAISES WARREN

Will Overcome Effects of Slump in 10 Years, He Says Here

Visiting Deyo Brothers farm near Binghamton with a class of students of the New York State College of Agriculture at Cornell, Professor H. R. Ross, head of the Dairy Industry school, today paid tribute to President Roosevelt and Dr. George F. Warren of Cornell, one of the "brain trust."

Dr. Warren, authority on farm management at Cornell and internationally known as an economist, fosters the commodity gold dollar plan, one of the most hotly discussed economic issues of the Roosevelt administration.

As explained by Professor Ross, Dr. Warren's theory is that the dollar should fluctuate with commodities.

"In other words," said Professor Ross, "Dr. Warren's contention is that the dollar which today will buy a given amount of given commodities should fluctuate so that tomorrow or next year it will buy a similar amount of similar commodities, whether the supply and demand for those commodities should increase or decrease.

"The plan is substantial and it is the belief of Dr. Warren that in 10 years, with such commodity dollar control, we will be entirely out of the depression. This is a modification of his original estimate that in less than two years we would be back to normal."

Discussing the manner in which leading economists of the country have accepted Dr. Warren's theory, Professor Ross declared that many contend such dollar fluctuation is impossible.

"Among those who disagree thoroughly with Dr. Warren," he said, "is Professor H. L. Reed, economics and finance professor at Cornell. He contends that such control is impossible."

Dr. Warren, according to Professor Ross, has made considerable practical research, especially along agricultural lines, in economic changes and developments.

"For a number of years," said Mr. Ross, "Dr. Warren has done this research work. It has been along an agricultural line more than in any other direction. But, agriculture is basic. It is a sound foundation for any economic research.

"Dr. Warren for years has had graduate students and others under his direction study the trend of economics in a given section over a period of years. This work usually is for theses and from these Dr. Warren has drawn conclusions which form for him a substantial background."

Discussing the administration policy in regard to inauguration of the "brain trust," Professor Ross points out that President Roosevelt is the first national executive to call on outstanding personages in educational circles for advice and assistance on such a large scale.

"President Roosevelt," he said, "departed from standard routine as President in having such advisors and has rather consistently backed up his 'brain trust.'

"But why shouldn't these educators be among the national advisors. Some of the leaders in education are among the most brilliant in the country. Many of them have an excellent practical background in addition to their theoretical side.

"Personally I am behind Roosevelt's policies in general. He is doing a difficult job."

Commenting on the proposed Federal plan for dairy control, the feature of which is to reduce milk production overhead by culling from dairy herd non-productive cows, the government to pay for such reduction on a fixed scale, Professor Ross said he was heartily in accord with the plan.

"It is the only natural thing to do," he explained, "many herd owners have been doing it for years. Why should a dairyman maintain an overhead of a fixed amount when he can reduce that overhead by eliminating poor producers and at the same time affect his income but little?"

Professor Ross each year brings classes of students to inspect the Deyo farm, which he declares "is one of the best and most practical dairy farms in New York state."

Today he and the class, comprising 12 students, were guests of I. T. Deyo, Binghamton, and one of the farmers. Mr. Deyo, together with Ross L. Hoag, farm superintendent, personally escorted the class through the stables and plant and about the farm, which covers 485 acres.

Mr. Deyo and Mr. Hoag explained the methods of operation of the dairy, the former outlining the history of the farm, which has been in the Deyo family since 1850.

Press and Sun-Bulletin
Binghamton, New York
May 10, 1934, Page 3

which meant it would devalue the dollar relative to gold. Therefore, lower the value of money and assets along with wages will rise as expressed in terms of that currency.

This was a first and important step in comprehending the role of money. But to the classical economists and bankers, this was pure heresy since they believed money should be tangible, which created deflation (AUSTERITY) and a mythical store of value.

Roosevelt suspended gold exports on his first day in office. This was not formally a suspension of the gold standard, but it was building a Berlin Wall around capital by using capital controls. At this point in time, nobody quite understood what effect such capital controls would have on the dollar and the economy.

By April 1934, Roosevelt announced to his Brains Trust that the country was off the gold standard. He then showed them the Thomas Amendment to the Agricultural Adjustment Act that allowed the president to devalue the dollar by 50% and issue $3 billion in currency without gold backing. The entire Brains Trust was horrified. Everything they had come to believe that the gold standard represented came to an abrupt end. Some argued there would be riots, civil unrest, and maybe even a revolution. Money needed to be backed by gold in their minds. Nothing of that nature took place. In fact, the opposite effect proved Warren was correct.

It is often not appreciated how much Roosevelt was very much an outsider looking in. He won the election because people wanted change, as was the case with Donald Trump. Roosevelt was the governor of New York, not a Washington insider. The entire Brains Trust was nothing more than a dog and pony show for publicity.

To the dismay of the Brains Trust, the stock market did not collapse to new lows. It rallied at first, then pulled back largely due to the number of bank failures and the bank holiday. Eventually, the stock market rallied as the devaluation of the dollar indeed sparked inflation.

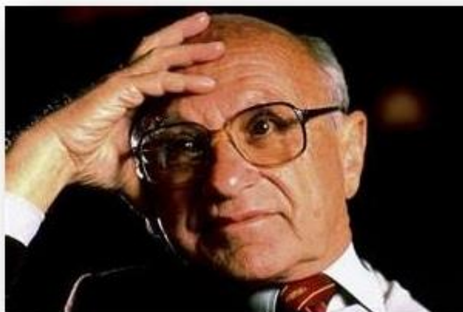
To the total amazement of the economists and bankers, this was the only act that made any real difference in turning the economy. The stock market continued to advance, rising sharply, and nearly doubling over the subsequent three months. The rally continued into 1937. Even wholesale prices began to rise, as did orders for industrial goods. Suddenly, it made no sense to hoard cash when it was perceived that it would buy less tomorrow.

The only thing that lagged behind was unemployment. This was a structural problem. Back in 1900, 40% of employment was in agriculture. With the Dust Bowl, there were simply no jobs available. Where we face a similar structural problem with the advancement of technology, this was also the employment crisis during the Great Depression. Tractors replaced manual labor in farming.

George Warren was approaching everything from the fringe and made a truly groundbreaking revolution in the concept of money, but that is where all major changes come from in every field. The traditional economic thought was that of austerity, and as such, they considered Warren a crackpot. The conventional wisdom simply failed to comprehend what money was or its role within the scope of our collective society. Under the austerity philosophy, governments are attempting to secure the value of the currency in purchasing power, yet they spend money like someone who just won the lottery.

The assumption that money had to be tangible was not correct for money rises and falls in value with economic booms (inflation) and recessions (deflation). The ultimate object is the medium of exchange between one thing (object or labor) for another (object or labor). What constitutes "money" is simply the medium of exchange like words that relay concepts between two parties. At the core, lies the perception of value and that fluctuates according to supply and demand.

Therefore, Warren demonstrated that if you wanted prices to rise, the value of the dollar had to decline. Thus, the only way to do that was to abandon the gold standard, which was the fixed exchange rate system.



Milton Friedman (1912–2006)

In "A Monetary History of the United States," published in 1963, Friedman and Anna Jacobson Schwartz famously argued that the Great Depression was due to the failure of the U.S. Federal Reserve to expand the country's monetary base, which was maintaining the austerity philosophy. Had there been no decline in the money stock, their argument goes, there would have been no Great Depression. That simply was not the case if they ever truly walked the streets and spoke to the people.

What was taking place was the natural human response. People hoard money and do not spend when a recession unfolds. They hold back and save. The velocity of money then declines, and this contributes to the scarcity of money itself. In fact, there was such a shortage of money that over 200 cities began to issue their own currency known as Depression Scrip to allow their local economies to function. Milton's interpretation was clearly valid. There was such a great shortage of money that private issues appeared around the nation.

United States Depression Scrip
1934 The City of Long Branch, New Jersey
ArmstrongEconomics.COM

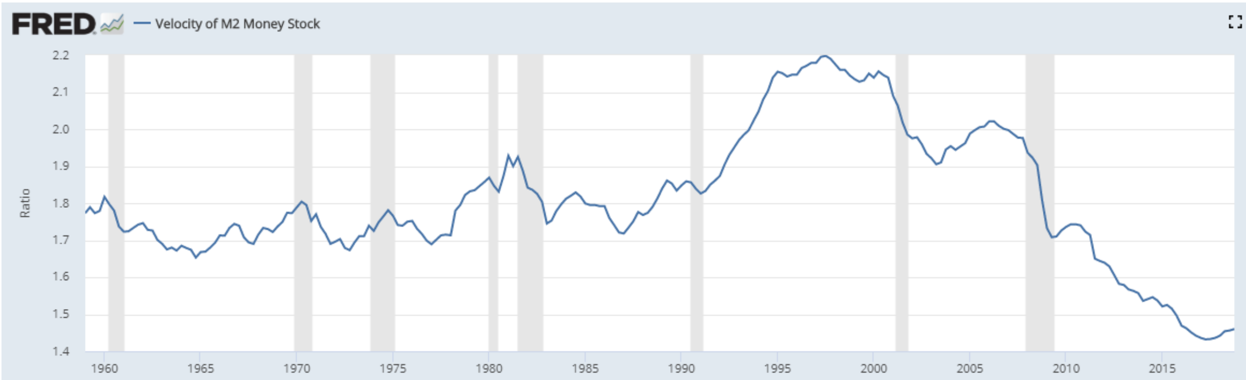
John Maynard Keynes (1883-1946)

Keynesian economics, on the other hand, was developed by the British economist John Maynard Keynes (1883–1946) during the 1930s in an attempt to understand the Great Depression. Keynes advocated for increased government expenditures and lower taxes to stimulate demand and pull the global economy out of the depression.

The problem with government intervention has always been corruption and the inability of centralized planning to manage an economy. This very idea was first propagated by Karl Marx (1818–1883) and justified the Communist Revolutions. In essence, the liberty and freedom of the individual are subservient to that of the state.

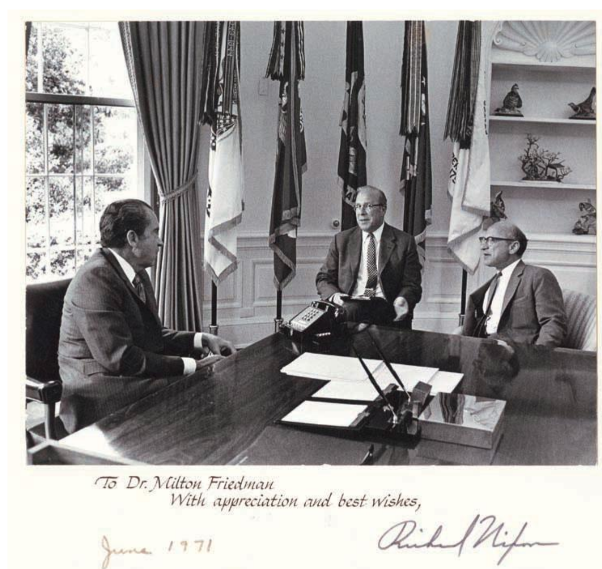
Karl Heinrich Marx (1818-1883)

Clearly, the Monetarist cure was one that retained the individual freedom and liberty of the people. The Keynesian solution followed along with the proposition that the government possessed the wisdom and ability to manipulate the demand of the people to inspire them to save or spend. The idea was based upon the inadequate understanding of the economy. Lowering interest rates will never stimulate demand unless the people see an opportunity to invest and have confidence in the future. As long as they remain skeptical of the future, they will neither borrow nor spend.



A simple look at the velocity of money demonstrates that even increasing the supply of money does not "stimulate" if people hoard and refuse to spend. It is all a matter of faith and belief in the future.

The stock market and economy have never peaked with the same level of interest rates twice. This is simply because it is a complex issue of human expectations at that moment in time. If people expect the stock market to double, they will pay a 20% annual interest rate. If they do not expect a 3% raise, they will not borrow at 3%. It is always the differential between the rate of interest and the expectation of the future.



However, it would be 1971 when the Bretton Woods system of a fixed rate also failed, which then led to the development of the floating exchange rate system in August 1971. It was Milton Freidman who argued that fixed exchange rates could not be maintained and that a floating exchange rate would automatically balance against the economic trends within a nation and eliminate the major crisis when currencies were forced to default.

The creation of the euro was the attempt to restore fixed exchange rates after realizing after the ERM crisis that such a scheme does not work. Currencies will always fluctuate. The solution was to create a single currency and abandon individual currencies. But the German fear of hyperinflation dominated and prevented the creation of the euro as a true single currency, which would have required the consolidation of the debts.

The Eurozone & the Threat to the World Economy

The lure of fixed exchange rates has been the dream of politicians for centuries as they assume it eliminates the free market check and balance against their policies, which Milton Freidman argued was the advantage of a floating exchange rate system. This lure of fixing currencies was behind the creation of the euro from the European viewpoint. Yet, the American vantage point saw the rise in the dollar into 1985, when the British pound fell to $1.03 from $2.40, as a true crisis when it came to trade, jobs, and politics.

It was the rise in the US dollar into 1985 that set everything in motion. James Baker (born 1930) became the secretary of Treasury on February 5, 1985. The dollar rose to record highs after Volcker raised interest rates to insane levels of 14% in 1981 to fight inflation. Capital poured into the dollar and sent it ever higher. Baker's solution was to create the Group of Five (G5) for a coordinated manipulation of the currency markets to force the dollar down.

September 22nd, 1985 - Plaza Accord

From left: Gerhard Stoltenberg of West Germany, Pierre Bérégovoy of France, James A. Baker III of the United States, Nigel Lawson of Britain and Noboru Takeshita of Japan.

The Plaza Accord to manipulate the dollar was struck in New York at the Plaza Hotel. Baker proposed that Europe ban together and create a single currency to compete against the dollar to bring it down. Individually, the dollar had no competitor. The G5 hoped that banning together would bring the dollar down to reduce the dollar trade deficit by making American exports more competitive.

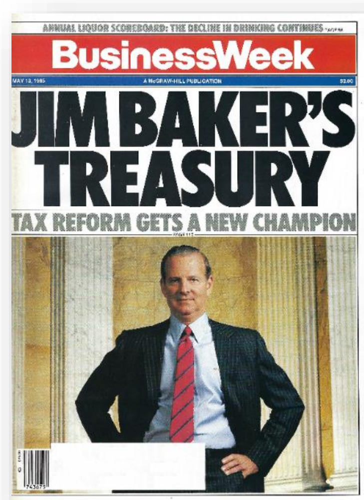
The Plaza Accord was signed on the 22nd of September 1985, when the proposal to create a single currency for Europe was envisioned. The euro was thus born in concept in New York City. This was James Baker's view of the world and how to solve the trade deficit, despite the fact that he was a lawyer. The United States was clearly taking the opposite view of the austerity policy that dominated the pre–Great Depression era.

The purpose behind the euro was to create a single currency to compete against the dollar. It was James Baker's idea that if there was a single European currency, then the dollar would not be the main currency and it would not rise excessively. Yet, when the Plaza Accord was announced, the dollar had already begun its decline. Indeed, the dollar began to plummet sharply and now the other members were objecting to the decline in the dollar from their trade perspective. This led to a subsequent meeting in Paris which became known as the Louvre Accord. This subsequent Paris meeting took place resulting in the Louvre Accord which was signed on February 22, 1987. This time the agreement was aimed to stabilize the international currency markets and halt the continued decline of the US dollar set in motion by what they presumed was caused by the Plaza Accord.

The agreement was signed by France, West Germany, Japan, Canada, the United States, and the United Kingdom. Italy declined to sign the agreement.

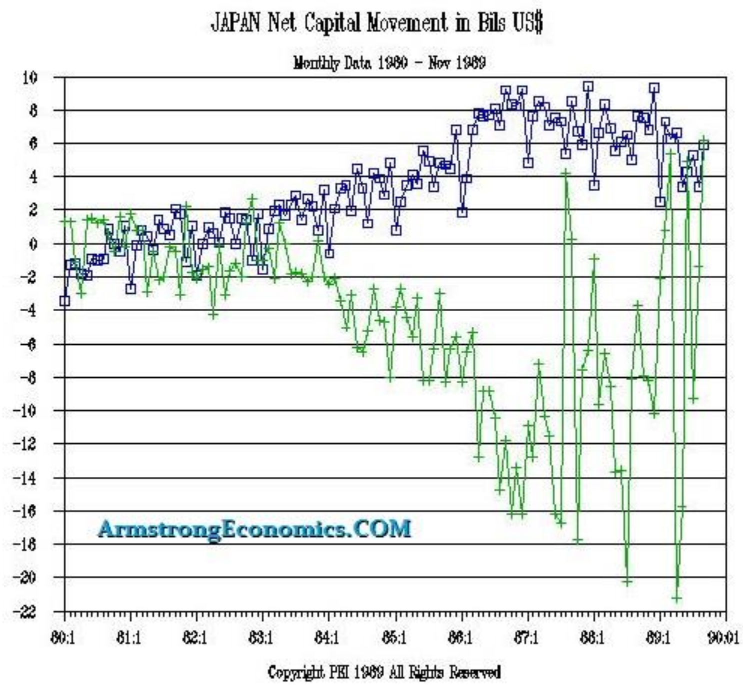
The G7 meeting of central bankers and finance ministers in Paris announced that the dollar was now "consistent with economic fundamentals." The G7 announced that they would only intervene when required to ensure foreign exchange stability. The objective was to manage the floating currency system.

Democrats gained control of Congress in 1986 and immediately called for protectionist measures. The dollar depreciation agreed to in 1985 at the Plaza Accord failed to improve the trade perspective. In 1986, the trade deficit actually rose to approximately $166 billion with exports at about $370 billion and imports at about $520 billion. Baker's manipulation of the currency to create jobs and alter trade flows proved to be a complete failure. Nevertheless, those in power keep trying the same philosophy endlessly with the same result — total failure.



Those in power never understand that lowering the value of a currency has never translated into the creation of jobs. They fail to understand that such policies have led to a shift in capital flows.

In the case of the Plaza Accord, the dollar was already declining. When the Louvre Accord was announced and the dollar continued to decline, suddenly the market traders saw this as a confirmation that the central banks had lost control. Capital began selling off US assets for fear that the dollar would plummet even another 40% in the months ahead. This crisis in confidence led to the 1987 Crash that traditional economics never saw coming with their myopic focus on domestic factors exclusively.



The Japanese, in particular, were suffering loses by financing US trade through purchasing United States Treasury bonds in an attempt to ease the trade deficit criticism. The dollar had already begun a decline prior to the Plaza Accord in August 1985. By the time we arrived at the Louvre Accord, the attempt to manipulate the foreign exchange markets to support the dollar proved to beyond the capacity of the G7. We can see the capital flow data between the USA and Japan began to move in early 1984, establishing the trend that nobody seemed to pay attention to at that moment.

The price action of the dollar clearly proves that the central banks lacked the power to truly influence the markets. The trend had begun prior to the Plaza Accord and it continued to decline following the Louvre Accord.

Nigel Lawson, who represented Britain at the Plaza Accord, was a big supporter of joining the euro at that time. His views to create a European single currency clashed with Prime Minister Margaret Thatcher who stood tall and refused to surrender British sovereignty or the British pound to James Baker's new world order. Maggie stated bluntly that the EU was attempting to create a political union rather than an economic one. On November 28th, 1990, she stood up in Parliament and stated: "A single currency is about the politics of Europe. It is about a federal Europe by the back door." Baker had not proposed going that far. He wanted to see a single currency for Europe to compete with the dollar. The idea of transforming Europe into the United States of Europe was centered around this idea that the way to end European wars was to surrender sovereignty to a single new European government.

Consequently, the euro experiment did not stop with the currency. Indeed, today we can see that Thatcher was right after all. It is all about the extinguishing of democratic rights to an unelected authoritarian central government established in Brussels. The EU was converted from a trade union to a political union with centralized control all on the theory that eliminating the independent European states would end European war. However, the dirty little secret is that they believed the people would never vote for their grand scheme. Thus, they eliminated any structural framework that would allow the people to have any vote whatsoever.

Of course, from the outset, European leaders denied that there was an agenda to federalize Europe. They swore that they were just creating a single currency to compete with the dollar. The German people have never been allowed to vote on any proposed treaty or to even join the EU. The Maastricht Treaty was only submitted to the people for a vote in Italy during 1989, which was purely an advisory referendum, held on May 18th, 1989, where 88.1% voted in favor before the Treaty was formed. However, following the treaty signing, only three countries held referendums on its ratification — Ireland on June 18th, 1992 with 69.1% in favor, France on September 20th, 1992 with 51.0% in favor, and Denmark on June 2nd, 1992 with 50.7% against. The second Denmark referendum was held just before the treaty of Maastricht passed after the first one was rejected. The 1993 Danish Maastricht Treaty referendum was held on May 18th, 1993, when 56.7% voted in favor. The second Danish referendum approved the treaty but amended with the opt-outs. No other European state even allowed its people to have a say on the entire euro creation. This has been an undemocratic move that was orchestrated because they knew the people would reject such a proposal.

The commission charged with formulating the new single currency attended our World Economic Conference. I warned that they had to consolidate the debts to create a single currency to compete against the dollar, for big money needed a place to park capital. I was told back then that the European population would see that as a bailout for some countries and all they wanted was to get the single currency through first, and then they would deal with the debt later. The whole agenda was to first federalize Europe and then sneak other agendas through as the people are always complacent.

The former President of France François Hollande (born 1954) spoke before the European Union Parliament to address the anti-Euro rising tensions. He explained that the entire purpose was to federalize Europe in order to prevent war. This has been the real agenda they no longer hide.

> "Why are the Chancellor and I here? Why the both of us? Because our populations are the biggest in Europe? That's not even true. Because we're the most important economies? Probably. Because there we 2 wars. Suring the last century opposing France against Germany. And those two countries, after the tragedy, wanted Europe to be, taking the horror that happened in the continent as a starting point. It's the reason why the representatives of Germany and France always wanted to take initiatives in new European constructions, like De Gaulle and Adenauer. We have remembered the Chancellor and I, the Treaty of the Elysée. Then it was Kohl and Mitterand, not only them, who made Europe take step forwards. That's why we're here."

The attempt to federalize Europe has conversely produced exactly the opposite of what the elite politicians believed. They assumed if there was only one government, there would be no European war. What they utterly failed to comprehend is the memories in Europe go back centuries. There are religious and cultural differences that are deeply entrenched within Europe that are not going to vanish so easily.

Additionally, the Refugee Crisis has also exposed a fatal flaw in the entire design of the EU as a federalized government. There has been rising civil unrest emerging because the decision to allow in the refugees was unilaterally made by Chancellor Angela Merkel for her personal political career. Merkel's decision was not voted on by all of Europe. She simply made that announcement. When millions set out for Europe, suddenly the EU began to demand that all member states had to accept the refugees. This entire event proved one simple thing. There could be no federalized Europe when a single member state could act unilaterally and impose their policy upon other member states against the desires of their local culture.

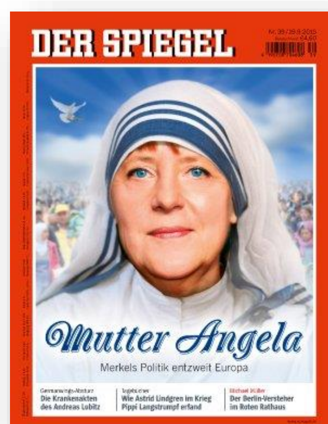
Of course, Angela Merkel has denied that allowing the refugees into Europe led to an increase in Islamic terrorist attacks. This entire problem exposed the flaw in the EU design. The very creation of the European Parliament, with no power to introduce or veto legislation by the Commission, proves there is a denial of democratic structure. Moreover, Chancellor Merkel collapsed in polls

internationally after her refusal to yield to Greece during its debt crisis. She allowed the Greek people to be strip-mined of assets to pay for their corrupt politicians.

Merkel's harsh actions toward Greece drew international condemnation. On July 15th, 2015, *Time Magazine* wrote, "Berlin's role as the enforcer in negotiations over Greece's debt could cause lasting damage to Germany's global image." Images of elderly Greeks committing suicide in Syntagma central square in front of the Greek Parliament in Athens made the front pages in the international press.

Merkel's international image was becoming that of a money-grubber without any humanity. Pictures of retired Greeks who were moved to tears after being unable to withdraw money from banks, who could not even buy food, cast a very cold-hearted image of Merkel globally.

Then, the *Washington Times* wrote on September 10th, 2015, "Angela Merkel welcomes refugees to Germany despite rising anti-immigrant movement." The entire refugee crisis was created by Merkel as a diversion because she was being personally viewed as the harsh enforcer of loans, which were structured to hide what Goldman Sachs had instituted to get Greece into the euro from the outset.



The entire reason for the refugee crisis was simply the view of Merkel globally. She needed to reshape her image from the loan shark to the caring Mother Merkel. Europe is now paying the price because career politicians were simply concerned about her polls.

The Refugee Crisis illustrated that the EU was not a federal government nor was the euro a true reserve currency. There was no consolidation of debts, and thus there was no federal debt to compete against the dollar. Bond investors still had to decide which member state to invest in, but over in the USA there was a federal debt. The 50 individual state debts traded based upon their own credit ratings, which is precisely what unfolded in Europe.

The European Parliament

Europe has become the most overregulated entity in the world, and as a direct result, it has produced the lowest economic growth with the highest unemployment. There are far too many regulations to comply with, and there are precious few new jobs being created by new business operations. This has suppressed the youth by casting them aside into what many now call the "Lost Generation" throughout Europe.

Thatcher knew the real machinations behind the curtain. Those in Brussels knew from the beginning the best sales job they could pull off was a monetary union that was not political. The pushed the former and hid the latter, always denying that as some conspiracy theory. They preached savings on foreign exchange to resurrect the Bretton Woods era of fixed exchange rates. They sold the idea that the Eurozone would be bigger than the United States economy and Europe would rise to its former glory. The mantra of a single currency hid the real agenda to federalize Europe. They were convincing themselves that a single government would eliminate European war. Their version of a one-world government, at least for Europe, ignored the cultural differences between the states.

The elite politicians sold the idea that a single currency would aid trade. They sold that idea while simultaneously swearing there was no federalist agenda. They regulated trade to the point that it became protectionism. This raised the cost of food and everything in Europe, thereby reducing the living standards for the people as a whole.

Margaret Thatcher tried to fight against that political agenda within her own cabinet. It was after the 1987 election when Thatcher became much more of an isolated figure within government. She was fighting with members in her own cabinet who wanted to join the euro as a new version of Bretton Woods minus the gold. There was some new world order in the creation of the euro; one government would eliminate war. Many in the UK bought into the idea that the euro would recreate Bretton Woods' fixed rate regime, which began with the European Exchange Rate Mechanism (ERM) introduced by the European Economic Community on March 13th, 1979. The Labour Party agreed to the euro for Thatcher became to Prime Minister on May 4th, 1979 after the ERM began. This was part of the European Monetary System (EMS) to reduce exchange rate variability and achieve monetary stability in Europe. This was preparation for the economic and monetary union and the introduction of a single currency, the euro, which took place on January 1st, 1999.

Thatcher's "The Bruges Speech" delivered September 20, 1988, will always be remembered. She stated bluntly:

> "I want to start by disposing of some myths about my country, Britain, and its relationship with Europe and to do that, I must say something about the identity of Europe itself. … Europe is not the creation of the Treaty of Rome. … Nor is the European idea the property of any group or institution."

Thatcher clearly saw the motivation behind the euro — the federalization of Europe as a political union to prevent European war by creating one government.

Nigel Lawson was in Thatcher's cabinet between 1981 to 1989. Lawson was in favor of privatization and contributed to Britain's Big Bang. However, he was a closet Bretton Woods guy at the time who felt strongly that currencies had to be fixed. He was not so much a goldbug, but wanted a fixed currency and that would be the ERM followed by the end goal of the euro.

Nigel Lawson (born March 11th, 1932)
Member of Margaret Thatcher's Cabinet from 1981 to 1989

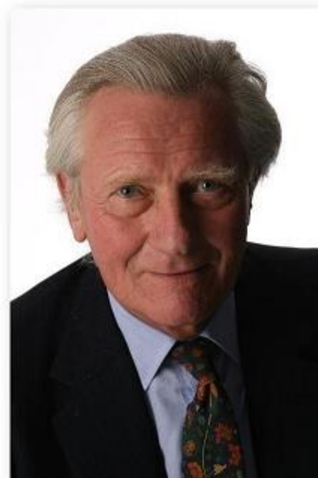
The issue of exchange rate mechanism membership (ERM) continued to fester between Lawson and Thatcher. Their feud was exacerbated by Thatcher's re-employment of Sir Alan Walters as personal economic advisor, who was my personal friend. Lawson's conduct of policy had become a struggle to maintain credibility once the August 1988 trade deficit revealed the strength of the expansion of domestic demand. As orthodox Keynesian monetarists, Lawson and Thatcher agreed to a steady rise in interest rates to restrain demand, but this had the effect of inflating the headline inflation figure. Yes, I explained how raising interest rates would attract foreign capital and fuel cost-push inflation. After all, I myself was standing in line to buy assets in Britain when the pound fell to $1.03 in 1985.

Lawson's fixing of the pound within the ERM is what led to the collapse of the pound. This was the clash with Thatcher, as Lawson favored the idea of the euro becoming a fixed rate currency system or a sort of rebirth of the Bretton Woods concept. The clash between Lawson and Thatcher, who was dead against the fixed rate idea of the euro, led to his resignation. Nigel Lawson delivered an ultimatum that Thatcher either fire Sir Alan Walters who supported a free-floating currency or he would resign. Lawson lost and he tendered his resignation as Chancellor of the Exchequer on October 27, 1989. Sir Alan Walters continued to favor a floating exchange rate and we had many discussions at the time concerning this issue. Lawson was succeeded in the office of Chancellor by John Major who later became her successor as PM. With time, Lawson saw the error of his ideas. He now opposes remaining in the EU and supports Brexit.

Sir Alan Walters
(1926-2009)

Geofrey Howe (1926-2015) was another key cabinet member who clashed with Thatcher over the euro. He masterminded the development of new economic policies embodied in an opposition mini manifesto. In June 1989, Howe and Nigel Lawson secretly threatened to both resign over Thatcher's opposition to British

membership in the exchange rate mechanism of the European Monetary System. Both Howe and Lawson were sold on the ERM and the coming idea of the Euro.



Michael Heseltine
(b 1933)
Member of Parliament (1966-2001) who failed in his attempt to become Prime Minister 1990 displacing M. Thatcher

In the last weekend of October 1990, Lady Thatcher travelled to a European summit in Rome where Jacques Delors' dream of a European Monetary Union was high on the agenda. But while Thatcher was fighting her lone battle against the prospective single currency abroad, she was being fatally undermined at home. Geoffrey Howe, her bitterest cabinet critic, went on television to tell the interviewer Brian Walden that in principle Britain did not oppose the euro.

Jacques Delors
(born 1925)
8th President of the European Commission (1985-1995)

Upon Thatcher's return, she delivered her Commons statement where she was forced to slap Howe down publicly stating, "This government believes in the pound sterling." Howe resigned on November 1st, 1990, from his position as Deputy Prime Minister over her refusal to agree to a timetable for Britain to join the European Exchange Rate Mechanism (ERM). The

ERM later collapsed, making George Soros famous, and resulted in Black Wednesday (September 16, 1992).

Lawson and Howe could not comprehend that Bretton Woods failed because fixed exchange rates never work. After resigning, Howe betrayed Thatcher by delivering a famous speech from the back benches that set in motion a leadership contest to oust Thatcher. They conspired against Thatcher as well as Britain. They knew she would not sign the Maastricht Treaty that eventually was signed on February 7th, 1992, just a few months before the ERM Crisis by her replacement, John Major.

Howe and Lawson would have destroyed the British economy had they joined the euro. After they signed the Maastricht Treaty, they fully intended to surrender the pound sterling. The only thing that saved Britain was the ERM Crisis a few months later when their overvaluation of the pound blew up in the faces.

Delors, in the private discussions I had with politicians at that time, seemed to believe that he was more so trying to defeat the USA than create a new world order. He was fixated that joining all the countries together would create a bigger GDP than the USA, and therefore the euro would displace the dollar. It was a power struggle arising from pride for many in France.


Evening Standard
Major and Hurd now set to fight Heseltine
THATCHER RESIGNS

Thatcher Resigns
November 22nd, 1990

Margaret Thatcher was forced to resign as Prime Minister and party leader in November 22, 1990, for defending British Independence and keeping Britain out of the euro. Michael Heseltine (b 1933) was also a former cabinet member appointed by Thatcher as Secretary of State for the Environment in 1979. Haseltine, I believe, betrayed Thatcher by launching a challenge to her leadership but only narrowly lost out.

In response to these members of her own cabinet who wanted to surrender British sovereignty to Brussels, Thatcher resigned so her party could place a more popular candidate against Heseltine. It was very clearly that Heseltine would have betrayed Britain for the idea of the euro.

Thatcher was driven from office for her belief in Britain and scepticism of European politics after two world wars. She was betrayed by most of her cabinet, leaving Parliament in tears. Finally, after retiring from the Commons in 1992, she was given a life peerage as Baroness Thatcher of Kesteven in the county of Lincolnshire, which entitled her to sit in the House of Lords. For a leader to be betrayed for defending her country's identity, the lack of political wisdom of her betrayers becomes self-evident.

Sir John Major
(born 1943)
British Prime Minister (1990 – May 2, 1997)

The British general election of 1992 result took many by surprise, as opinion polling leading up to the Election Day had shown the Labour Party winning under leader Neil Kinnock. Once again, they got it totally wrong back then. The Conservatives were led to victory under John Major (born 1943) with slogan, "You Can't Trust Labour."

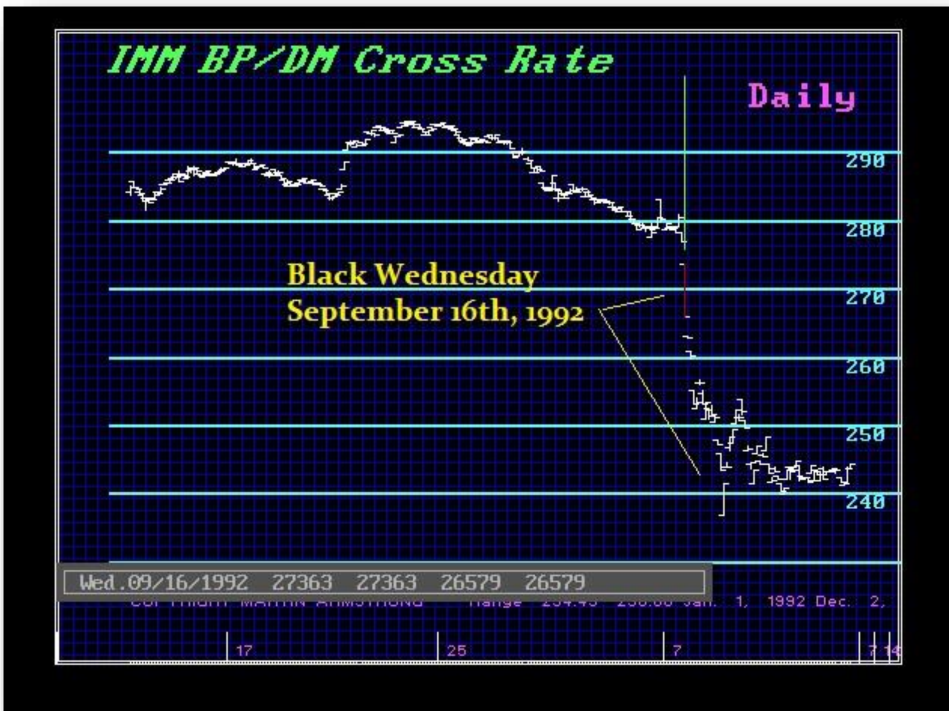
John Major had won the leadership election in November 1990, following the resignation of Margaret Thatcher thanks to the attempt of Heseltine to become Prime Minister. During Major's term leading up to the 1992 election, he oversaw the British involvement in the Gulf War, introduced legislation to replace the unpopular Community Charge with Council Tax, and signed the Maastricht Treaty. The economy was facing a recession around the time of Major's appointment following the collapse of the Japanese Bubble in December 1989.

THE Sun
PHOTO FINISH
If Kinnock wins today will the last person to leave Britain please turn out the lights
TENNIS HERO ASHE HAS AIDS

The opinion polls got it dead wrong in the 1992 election once again. This was one of the most dramatic elections in the UK since the end of the second World War. The Conservative Party received what remains the largest number of votes in a general election in British history, breaking the record set by Labour in 1951. The Sun ran one headline writing, "If Kinnock wins today will the last person to leave Britain please turn out the lights."

The monetary crisis that John Major faced was joining the European Exchange Rate Mechanism (ERM), which was set up in March of 1979 in order to reduce exchange rate variability and stabilize monetary policy across Europe before introducing a common currency. It was a vain attempt to create a peg, resurrecting Bretton Woods.

Britain initially declined to join the ERM when it originated, but later adopted a semi-official policy that shadowed the Deutsche Mark only after they forced Marget Thatcher to resign. In late 1990, the country decided to join the ERM after a shake up in leadership, preventing its currency from fluctuating more than 6% in either direction by intervening in the currency markets with countertrades. The peg, which Thatcher said would fail, did so in a very spectacular manner.



Of course, they blamed George Soros for breaking the pen and the ERM, but in fact, what became known as Black Wednesday was simply caused by the bad monetary judgment by all those who shunned Thatcher from politics.

When Britain joined the ERM, the rate was set to 2.95 Deutsche Marks per pound sterling with a 6% permissible move in either direction. The problem was that the country's inflation rate was three times that of Germany's, interest rates were at 15%, and the country's economic boom was far into a period of unsustainable growth. This set the stage for a bust period when there was no such boom in Europe.

Currency traders took note of these underlying problems and began short selling the pound sterling. George Soros was one of these bearish currency traders, amassing a short position of more than $10 billion worth of pound sterling.

They staged a coup against her to take the UK into the euro. She was not against the EU as long as it remained a trade union. We had discussions on that subject. Maggie said at the Bruges Speech:

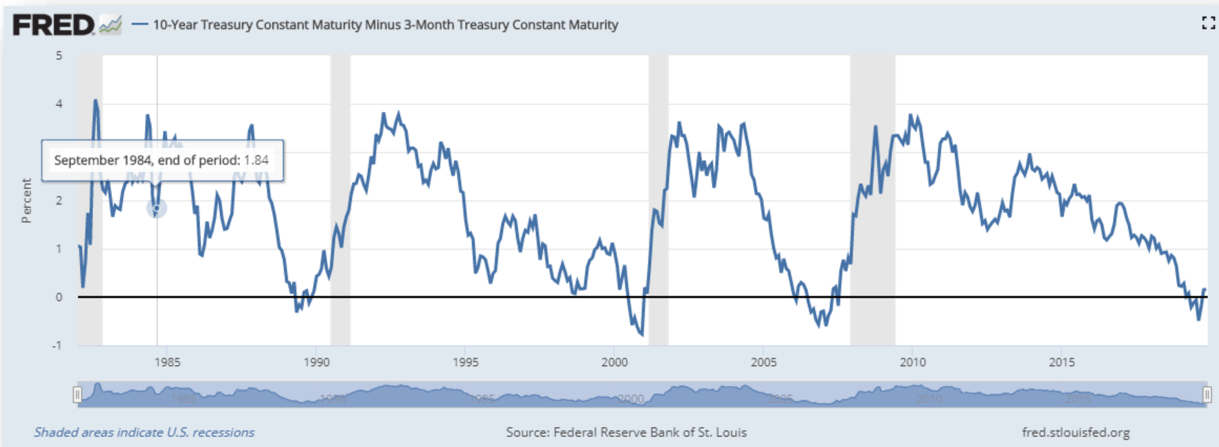
> "We have not successfully rolled back the frontiers of the state in Britain, only to see them reimposed at a European level with a European superstate exercising a new dominance from Brussels."

While some people are claiming she would never have had a referendum, that is total nonsense. Her Poll Tax was to make people have a stake in government and then they would vote and pay attention. That was her true motive behind that step, which nobody understood, and it backfired on her. She was against the euro and the federalization of Europe; she would definitely move to exit the EU under these terms. She would have never agreed to surrender the sovereignty of Britain.

Using her Bruges Speech to twist things around that she would have been against a referendum and would be in the remain camp is nonsense. We had deep discussions about the problems with the euro. The commission designing the euro came to our WEC in London. I met with them about the structural design of the euro. I think I knew where this went all wrong, and I knew where Maggie stood. She also respected that I was one of the leading currency specialists on the subject with real experience and not just theories.

While there has been a single federalized government, some member states have made unilateral decisions like Merkel allowing refugees in, which has now created a European crisis.

The Inverted Yield Curve



During the week of March 25, 2019, analysts were spooked by a scenario known as the "inverted yield curve," which occurs when the interest rates on short-term bonds are higher than the interest rates paid by long-term bonds. Traditionally, this meant that people were worried about the near-term future and were piling into safer long-term investments, or so the press told the world. However, our models show something different unfolding — a liquidity crisis not seen since 1998.

In a normal economic boom, bondholders typically demand to be paid more for longer-term debt instruments than they do for short-term bonds. Generally, this is because longer-term bonds require people to lock their money up for a greater period of time and the risks over longer periods of time are typically greater. Capital demands to be compensated for that risk. In contrast, bonds that require investors to make shorter time commitments, say for three months, don't require as much risk and usually pay less.

After a brief bounce, the yield curve turned south during the summer of 2019. This time, the yield on the 10-year U.S. Treasury bond fell below that of the T-Bill 3-month note, which was moving into a sustained inverted position for the first time since 2007. This sent shivers down the spines of the domestic analysts who immediately began forecasting a major recession. That failed to materialize, and the stock market rallied to make new highs once again.

However, our computer was picking up completely different correlations. While the typical forecast was predicting doom and gloom and an inevitable recession that would drive Trump from office, we warned that there would be no serious recession in the United States and that the contraction was primarily in Europe with Asia running a close second. In that regard, we warned that the inverted yield curve was conforming to the Economic Confidence Model (ECM), which had been warning that this last leg should be a hard landing economically for most of the world.

The media immediately pronounced that the US would move into a recession and this would end Trump's chances for reelection. The *Washington Post* on August 22nd, 2019, virtually called him a liar and reported his own staff said the country was going down the tubes in a recession.

Recession ahead? Trump insists economy is strong

Kevin Freking
ASSOCIATED PRESS

BERKELEY HEIGHTS, N.J. – President Donald Trump dismissed concerns of recession on Sunday and offered an optimistic outlook for the economy after last week's steep drop in the financial markets.

"I don't think we're having a recession," Trump said. "We're doing tremendously well. Our consumers are rich. I gave a tremendous tax cut and they're loaded up with money."

A strong economy is key to Trump's reelection prospects. Consumer confidence has dropped 6.4% since July.

The president has spent most of last week at his golf club in New Jersey with much of his tweeting on talking up the economy.

Democratic presidential candidate Beto O'Rourke said the U.S. needed to work with allies to hold China accountable on trade. He said he fears Trump is driving the global economy into a recession.

"This current trade war that the president has entered our country into is not working," O'Rourke said. "It is hammering the hell out of farmers across this country."

Last month, the Federal Reserve reduced its benchmark rate – which affects many loans for households and businesses – by a quarter-point to a range of 2% to 2.25%. It's the first rate cut since December 2008 during the depths of the Great Recession. Federal Reserve Chairman Jerome Powell stressed that the Fed was worried about the consequences of Trump's trade war and sluggish economies overseas.

"Weak global growth and trade tensions are having an effect on the U.S. economy," he said.

Breaking with historical norms, Trump has been highly critical of Powell as he places blame for any economic weakness on the nation's central bank for raising interest rates too much over the past two years.

"I think I could be helped out by the Fed, but the Fed doesn't like helping me

A strong economy is key to President Donald Trump's reelection hopes, but consumer confidence has dropped.
NICHOLAS KAMM/AFP/GETTY IMAGES

too much," Trump said..

Peter Navarro, who advises Trump on trade policy, shared that sentiment.

"The Federal Reserve chairman should look in the mirror and say, 'I raised rates too far, too fast, and I cost this economy a full percentage point of growth,' " Navarro said.

Trump acknowledged at least a potential impact on consumers when he paused a planned 10% tariff hike for many items coming from China, such as cellphones, laptops, video game consoles, some toys, computer monitors, shoes and clothing.

"We're doing (it) just for Christmas season, just in case some of the tariffs could have an impact," Trump said.

Navarro would not go even that far, saying Sunday "there's no evidence whatsoever that Americans consumers are bearing any of this."

O'Rourke spoke on NBC, and Navarro appeared on CNN's "State of the Union" and CBS' "Face the Nation."

Trump maintained that China's economy is struggling because of the tariffs and would like to make a trade deal with the U.S. He said he could make a "bad deal" and the stock markets would go up, "but it wouldn't be the right thing to do.

"I'm just not ready to make a deal yet," Trump said. "China would like to make a deal. I'm not ready."

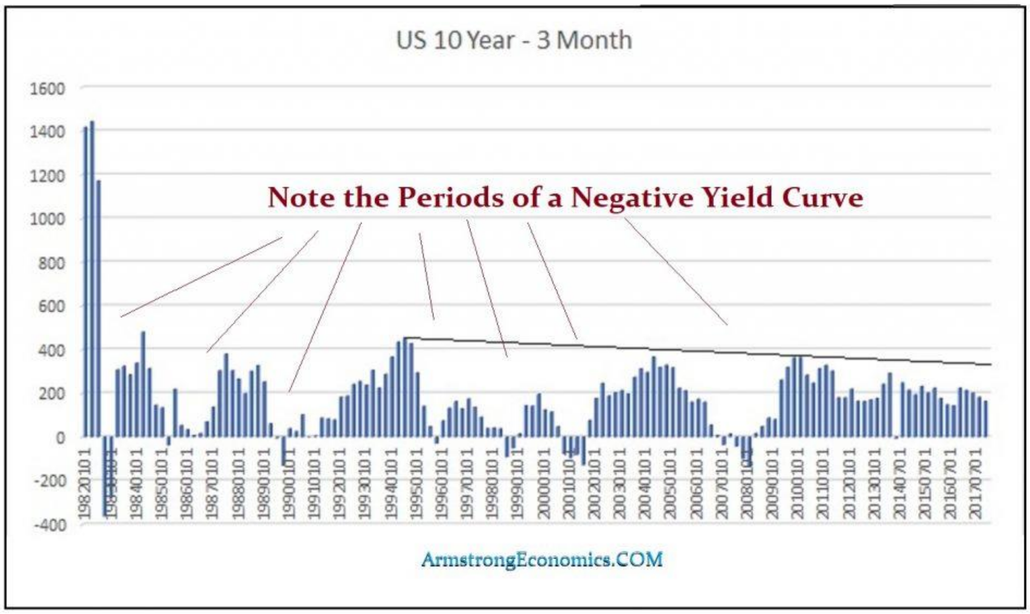
Associated Press, Star-Gazette Elmira, New York
20 Aug 2019, Tue · Page A9

The *Associated Press* ran similar stories all predicting a recession based upon the appearance of the inverted yield curve. Our models warned that the opposite was unfolding. That sudden rise in short-term rates was a precursor, not to a recession but to a liquidity crisis that we warned would unfold after Labor Day beginning in September 2019, which has manifested as the Repo Crisis. That forecast came in on target beginning on 17th that month.

When the inverted yield curve first appeared in March 2019, our model was picking up the shifts in global capital flows. Our blog post on March 28th, 2019 warned:

> "Nonetheless, while the yield curve has inverted, it has done so in a rather unusual manner. This is **NOT** suggesting a major recession in the United States. Instead, it is a reflection of global uncertainty outside the USA."

This inverted yield curve confirmed that there was political chaos emerging around the world that was intensifying. This was resulting in massive dollar hoarding as more foreign capital began to park in dollar assets. With the May 2019 European elections on the horizon in Europe, the capital flows were still pouring strongly into the dollar. The foreign capital has been buying the 10-year notes driving the spread lower. Just look at the daily chart of the euro and you will see it has taken a nose-dive from the March 20th high.



At the WEC session in 2016, we forecast that real rates would rise. We warned that the short-term rates can spike upward faster than expected. There were gaps in reversals that appeared on the discount rate. This warned that the Fed could lose control of short-term rates, which is precisely what has taken place with the Repo Crisis.

The last key high came at a 3.65% premium over the 3-month T-Bill rate during the first quarter of 2010. The Quarterly Bearish Reversal rested at 2.61% and the next one presented a huge gap down to 0.87%. That first Quarterly Bearish was elected by the third quarter of 2010. The spread went negative in the fourth quarter of 2013. This is what happens when we have these gaps. We warned on the blog on January 25, 2018, that we will "discover that the yield curve just may swing into a negative position again rather uncontrollably rather than intentionally."

Even the yield curve using the 10-year to the 2-year has been in a major decline ever since our War Cycle turned in 2014. The yield curve (10-2 year) has not inverted. This is clearly showing the capital flight to the dollar that has been going on post-2014. This is not reflecting a major recession in the USA, but it is inferring that the ECM will be turning soon. We are in serious trouble globally as people are turning away from the established political norms and moving toward the opposite.

Therefore, the traditional analysis for stock market investors has been that an inverted yield curve was typically a sign that equities could peak, and an economic recession would follow. It has also been a precursor to a bear market in stocks, where equities fall 20% or more from highs which is the typical forecast. Some have pointed to the escalating trade war with China. Investors, they claim, are worried that the Chinese trade war and U.S. tariffs will slow global economic growth. All these scenarios were clearly being put out there for political purposes.

The 10-year Treasury note yield fell to 2.24% in early trading on May 29. Yields on 3-month Treasury bills rose to 2.35%, well above the 10-year rate. The 10-year Treasury note fell below 2% on June 25 following the release of weaker than expected consumer confidence data. The 3-month note traded at 2.13.%. The 10-year rates stood at 2.69% at the start of 2019. On June 4th, 2019, the 10-year Treasury notes slipped to 2.1% in midday trading, its lowest level in 20 months.

But the real trend driving the inverted yield curve is capital inflows seeking long-term yields. Much of the capital has moved in from Europe where the negative yields have resulted in the euro being rejected as a reserve currency.

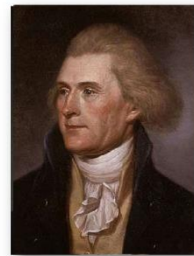
Moreover, the amount of money in fixed-income exchange-traded funds passed $1 trillion in 2019, an ascendance that has reshaped the market in which countries and companies raise money to pay their bills. This has also altered the yield curve. These forces have changed the dynamics of the marketplace, and the traditional inverted yield curve does not necessarily mean what it once did. The inverted yield curve was merely a confirmation of the pending Repo (Liquidity) Crisis.

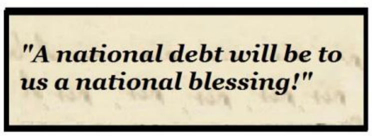
The Transfer of Volatility from FOREX to Bonds

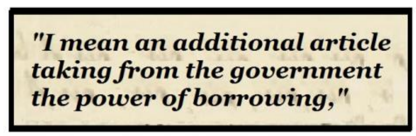
The proper structure of the euro would have required the consolidation of the debts from the outset, thereby creating a national debt for the European Union. Thereafter, the formation of a national European debt would have created a place for capital to park, and thus would have enabled the euro to actually compete against the dollar. All the claims that the euro would defeat the dollar because the EU would have a bigger economy proved to be wishful thinking by people who never understood capital flows or monetary history for that matter.

This fear that consolidating the debts would be inflationary was really absurd. The structure adopted was one of a dictatorship. The budgets of each state would have to be approved by the central committee. That meant member states would, in fact, have to surrender part of their sovereignty to Brussels. In creating the U.S. dollar, Alexander Hamilton consolidated the debts of the colonies for they all contributed to the Revolution.


Alexander Hamilton
(1755 - 1804)


Thomas Jefferson
(1743 - 1826)





In 1790, Alexander Hamilton created a Sinking Fund to clear up all the legacy debts after the American revolutionary war. This was the Hamiltonian Model. But there were consequences that we must look at in detail, for this plan led to Federalism and civil unrest. In 1781, Alexander Hamilton wrote a letter to a friend in which he discussed government spending. "A national debt, if it is not excessive, will be to us a national blessing," he wrote.

Thomas Jefferson, however, took quite a different view. Jefferson said that public debt was a danger and to be greatly feared. In 1798, he wrote a letter to his friend John Taylor in which he addressed amendments to the constitution. Jefferson wrote, "I mean an additional article taking from the government the power of borrowing."

Hamilton was the politician. Jefferson was the statesman. As all government descends down the dark staircase of corruption until it is compelled to extinguish its own life by suicide, Jefferson was already under assault by those who hated him for his honor, dignity, and steadfast belief in the liberty of the people. When asked what he would choose between government or the free press, he chose the latter.

Hamilton, wrote in the Federalist No. 11, in 1787:

> "Let the thirteen States, bound together in a strict and indisoluble Union, concur in erecting one great American system, superior to the control of all trans-Atlantic force or influence and able to dictate the terms of the connection between the old and the new world!"

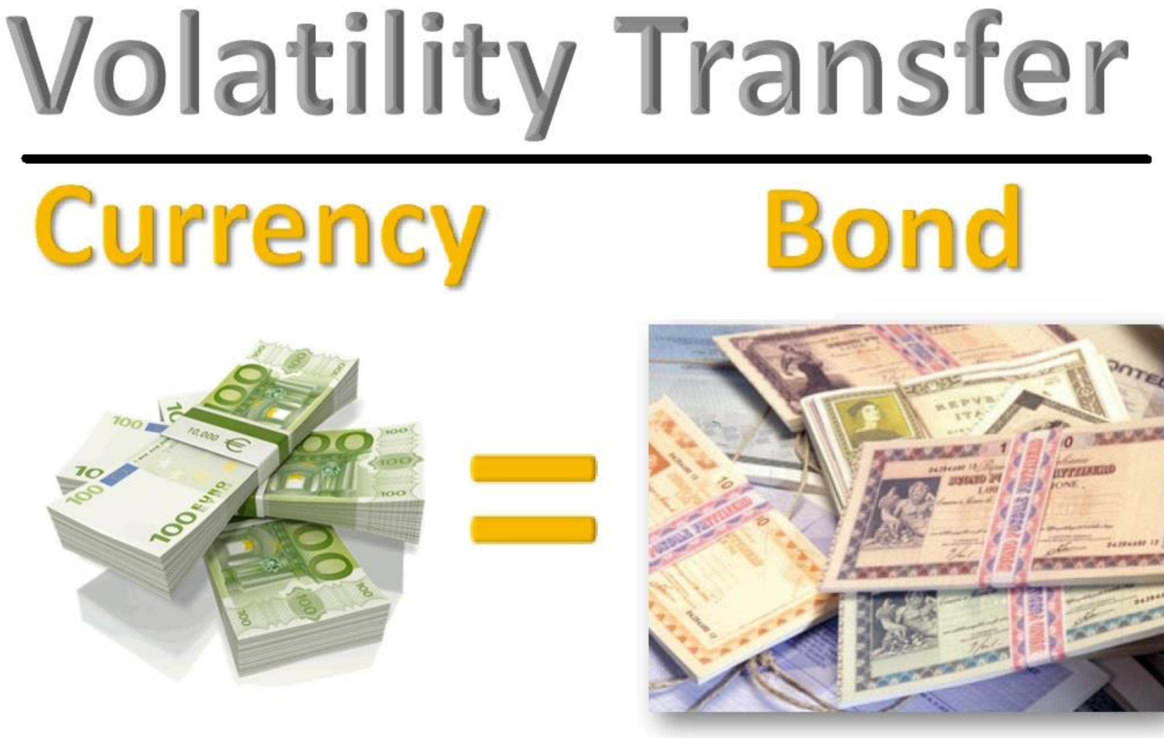
Hamilton knew precisely what he was doing. There was opposition then as there is today in creating a single European debt. However, the consolidation of the debts created a bond and solidified the federal government. Nevertheless, it did not impact inflation as the Germans feared. The prior debts were consolidated, and each state thereafter was on its own. The Federal government did not need to interfere in the budgets of each state.

Under the structure of the Eurozone, each member retained their debt and then the central government imposed dictatorial powers over their budget. This occurred out of the fear that if one state printed too many euros, it would reduce the value of the currency for all.

Country codes

(1) Uncirculated euro banknotes issued by the Banque centrale du Luxembourg bear the code of the central banks of the countries where the banknotes for Luxembourg are produced.
(2) Belgium Z
(3) Germany X
(4) Estonia D
(5) Ireland T
(6) Greece Y
(7) Spain V
(8) France U
(9) Italy S
(10) Cyprus G
(11) Latvia C
(12) Luxembourg (1)
(13)
(14) Malta F
(15) Netherlands P
(16) Austria N
(17) Portugal M
(18) Slovenia H
(19) Slovakia E
(20) Finland L

Since there was no consolidation of the debt to form a true centralized government, each state also retained their central banks. Even more absurd, where only the federal government creates dollars in the USA, the failure to consolidate the debts also meant that each national central bank within the Eurozone retained the right to print their own currency and strike coins. The member state issuing the printed note is indicated by a letter or country code preceding the serial number, as shown here. This particular banknote, bearing the letter "S", was printed for the Banca d'Italia. Here we ended up with a currency system that proved that there was no true centralized government in Europe. The ECB does not print money, which is a function of the Federal Reserve in the United States. Consequently, we have a euro that lacks a national central debt into which capital can park and a currency that can be printed by any state with a dictatorial power over member budgets.



The volatility that was standard in currencies was simply transferred from the currencies to the bonds. The proposition that a single currency would produce a single interest rate, pointing to the United States, only confirmed that these people have no idea how the financial markets function. They were comparing the national debt of the United States to a single currency and ignored the fact that 50 states had different interest rates based upon their credit rating.

The euro was a single currency, but that alone did not mean that all 50 states had the same interest rate simply because they issued debt in dollars. Either this was a deliberate lie to sell the euro or this reflected the complete stupidity of those pushing this idea that all of Europe would enjoy the same low interest rates as Germany.

Consequently, the volatility reflected in currency movement was merely transferred to the local bond markets. Currency was where capital voted on the confidence of each government around the world. The creation of the euro did not extinguish that volatility, it simply transferred it from currency to both the bond and share markets in Europe.

The German Bunds have steadily rallied since 1992 and the ERM Crisis. They have been the leading hedge against the euro by buying German Bunds and selling all other member states.

The euro failed to eliminate the FX risk. It simply transferred it to the bond and share markets.

The European Sovereign Debt Crisis (2010-2012)

The European Sovereign Debt Crisis that began in 2010 was by far the beginning of what remains the Mother of All Financial Crises. The greatest threat to the world economy began in 2010 and escalated into 2012. The crisis began in 2010 when the world first realized that Greece could default on its debt. The years that followed saw the debt crisis escalate into the potential for sovereign debt defaults from Portugal, Italy, Ireland, and Spain.

Indeed, the European Union struggled to support these weakened member states in an effort to hold the Eurozone together. They initiated bailouts from the European Central Bank (ECB) and the International Monetary Fund (IMF), but neither of these measures subdued the rising concerns or reduced the volatility as the euro crashed from its high in 2008. Many began to see the structural flaws behind the Eurozone and questioned the viability of the euro itself. Indeed, adopting negative interest rates by the ECB has only damaged the euro as a viable reserve currency.

The unrealistic problem that came to the surface was the fact that there were no penalties for countries that violated the debt-to-GDP ratios under the Maastricht Criteria. Indeed, even France and Germany were spending above the limit. This meant there was no way to impose fines when even France and Germany did not comply with the unrealistic criteria. The only penalty under the Maastricht Criteria was expulsion from the Eurozone, which would undermine the entire idea behind the euro and weaken the EU's power.

The misrepresentation that the euro would result in the same interest rate for all member states was the main selling point, despite the fact that it was false. The presumption that all members would enjoy the low-interest rates and increased investment capital led many to overspend under the belief that the euro would create happy days again and endless borrowing capacity at cheap rates.

The stark reality was very different from the one-size-fits-all propaganda the EU used to entice membership. The vast majority of capital inflows moved into Germany and France rather than the southern nations, which remained in the eye of international capital as spendthrifts. The capital inflows increased liquidity at first which led to wage and price increases. This raised the cost of living, especially in southern Europe, and reduced trade exports as the euro rose into 2008 to the $1.60 level, which made Europe very uncompetitive. Countries in the Eurozone suddenly lost their ability to raise their local interest rates to cool inflation or devalue their currency in a recession as they traditionally had done for decades. During the recession, tax revenues fell, but public spending rose to pay for unemployment and other benefits. The single currency meant they surrendered monetary policy and the only tool individual states had was fiscal policy, which politicians would never exercise for fear of losing their jobs.

The austerity philosophy imposed by Germany became an engine for deflation, which only slowed economic growth and rendered monetary policy even more restrictive. This philosophy resulted in expanding unemployment, reduced consumer spending as people shifted into a saving mode as occurs in all recessions, and it further reduced the capital available for lending.

Greek voters were fed up with the recession and shut down the Greek government by giving an equal number of votes to the "no austerity" Syriza Party, which in the end sold out the people for the status quo. Rather than leave the Eurozone, the new Syriza government worked to continue with austerity against the people.

Finally, in May 2012, German Chancellor Angela Merkel developed a 7-point plan, which went against newly elected French President Francois Hollande's proposal to create Eurobonds. Germany has continually rejected a national debt for Europe. Hollande was also warning that they must cut back on austerity measures and create an economic stimulus. Merkel's 7-point plan was as follows:

1. Launch quick-start programs to help business startups
2. Relax protections against wrongful dismissal
3. Introduce "mini-jobs" with lower taxes
4. Combine apprenticeships with vocational education targeted toward youth unemployment
5. Create special funds and tax benefits to privatize state-owned businesses
6. Establish special economic zones like those in China
7. Invest in renewable energy

Merkel argued that this was how they integrated East Germany. She argued that austerity measures could boost the competitiveness of the entire Eurozone. Her reasoning was faulty and has proven to be dead wrong. Austerity supports the bondholders against the people. Her 7-point plan followed the 2011 Intergovernmental Treaty approved on December 8th, 2011, whereby the EU leaders agreed to create a fiscal unity parallel to the monetary union that had already been implemented.

The staunch austerity policy of Germany imposed on Greece began to result in major conflicts. The United Kingdom and several other EU countries that were outside of the Eurozone criticized Merkel's treaty. They were deeply concerned that Merkel's treaty would lead to a two-tier EU. Eurozone countries could create preferential treaties for their members only and exclude EU countries that don't have the euro. This was becoming a serious loophole.

Because Germany was the largest economy in the EU, it also maintained a virtual dictatorship over the EU who saw itself as dependent upon Germany's support. The 2011 Intergovernmental Treaty had three primary effects. First, it reassured lenders that the EU would stand behind its members' sovereign debts. Secondly, it enforced the budget restrictions of the Maastricht Treaty. The third and final impact was it enabled the EU to act as a more integrated unit since the Eurozone member states legally surrendered a portion of their budgetary power to centralized EU control. This was seen as merging the fiscal policies with monetary policies.

Business

careerbuilder

JOB LISTINGS

LOCAL NEWS

ITHACA

Cornell offers business resources

U.S. credit woes hit European banks

Star-Gazette, Elmira, New York, September 30, 2008, Tuesday • Page 20
story by Associated Press

In all reality, the European Sovereign Debt Crisis truly began in 2008 when the euro rose to $1.60 and forced Iceland's banking system to collapse. This started the contagion that then spread to Portugal, Italy, Ireland, Greece, and Spain going into the low of the global recession in 2009. It has led to a loss of confidence in European businesses and economies.

The Icelandic financial crisis was an economic and political event that involved the default of all three of the country's major privately-owned commercial banks in late 2008. The crisis led to the collapse of the krona and nationalization of the three banks in early October 2008. This compelled Iceland to secure help from the IMF. Virtually no other private creditor would lend the banks anything. Iceland petitioned the IMF in November, who agreed to a $2.1 billion two-year standby credit facility supplemented by other Nordic countries, Poland, Britain, the Netherlands, and Germany. The package was $10.2 billion in total, which was the largest economic bailout in history exceeding more than 50% of Iceland's total GDP. The crisis led to a severe economic depression in 2008–2010 and significant political unrest.

The greatest European fear was a contagion that would take down the euro itself. Various credit rating agencies downgraded several Eurozone countries' debts. Countries receiving bailout funds were required to meet austerity measures that were designed to slow down the growth of public-sector debt as part of the loan agreements. This was anti-Keynesian economics. Their austerity policies succeeded in creating the European Great Recession of 2008 to 2012.

Indeed, the austerity policy of the EU had resulted in the peripheral Eurozone member states of Greece, Spain, Ireland, Portugal, and Cyprus being unable to repay or refinance their government debt in 2009, no less bail out their struggling banks. The European Central Bank (ECB), the IMF, and, eventually, the European Financial Stability Facility (EFSF) all had to come to the rescue as the Eurozone was starting to crack.

It was also in 2009 when Greece first revealed that its previous government had grossly underreported its budget deficit and engaged in questionable deals with Goldman Sachs. This was obviously a violation of EU policy, which merely escalated fears about the survivability of the euro.

Goldman Sachs

Greece joined the euro late in 2001 under Costas Simitis. At the time, Greece owed about €3.4 billion euros it had borrowed. Goldman engineered a currency swap whereby the Greek debt, issued in dollars and yen, was exchanged for euros that were priced at a "historical" or entirely fictitious currency rate. Of course, swapping dollar and yen debt at nearly the low of 2000 when the euro was only 82 cents to the dollar became a nightmare. Greece's debt doubled in real terms as the euro then rose to $1.60 by 2008.

Obviously, Goldman offered no advice but structured a deal that only benefited itself by directing Greece to sell the dollar at the low. Goldman also set up an off–market interest–rate swap to repay the loan off the books, which was a currency position and therefore not technically a "loan" outside any reporting requirement as debt. The trade kept this part of the Greek debt off the books and cleverly hidden from scrutiny. This falsely created the idea that the Greek debt was moving in the right direction to meet the Maastricht rules eventually.

Goldman overpriced the deal to such an extent that 12% of their $6.35 billion in trading and investment revenue for 2001 came from restructuring Greece. In total, they pocketed a premium fee of $300 million. Goldman also warned, as they typically do, that they would cancel the offer if Greece shopped the deal around for a better price. Goldman further demanded that Greece pledge landing fees from Greek airports and revenue from the national lottery as part of the transaction to secure their own profits, strip–mining Greece.

Within just three months of signing the deal, the bond markets took a

EU seeks details of Greece's financial dealings

MARIA PETRAKIS
BLOOMBERG NEWS

ATHENS, Greece — European Union regulators ordered Greece to disclose details of currency swaps after the nation's Finance Ministry uncovered a series of agreements with banks that may have been used to conceal mounting debts.

The swaps were employed to defer interest payments by several years, according to a report commissioned by the Finance Ministry in Athens. The report didn't identify the securities firms that arranged the swap contracts, but the government turned to Goldman Sachs Group in 2002 to get $1 billion through a swap, according to the former head of Greece's Public Debt Management Agency.

Eurostat, the EU statistics office, gave Greece until the end of the month to provide more information on the currency swaps, which may have worsened the nation's financial health. Standard & Poor's and Fitch Ratings also are questioning the Greek government.

"Greece used accounting tricks to hide its deficit, and this is a huge problem," Wolfgang Gerke of the Bavarian Center of Finance in Munich, Germany, said in an interview. "The rating agencies are doing the right thing, but it may be too little too late. The EU slept through this."

EU leaders are pressing Greece to get its budget deficit under control. The issue poses the biggest threat to European unity in the 11-year history of the euro, the common currency for 16 nations.

EU members are supposed to keep deficits to less than 3 percent of gross domestic product, but Greece's is an estimated 12.7 percent.

Goldman Sachs didn't respond to a request for comment. ❑

Bloomberg News: Democrat and Chronicle
Rochester, New York, 16 Feb 2010, Tue • Page 11

major swing following the September 11th attack in New York during 2001. Furthermore, the dollar declined and the euro soared. Greek officials began to realize that the deal was not going well in the least. The Greek national debt nearly doubled in size, and in real terms (currency adjusted), the debt would double by 2008 just in euro terms nominally.

Greece faced another financial crisis in 2005, which few understood. Goldman Sachs "restructured" the deal once again, but this time they were selling the interest rate swap to the National Bank of Greece with the new government that came to power in 2004 under Karamanlis. This increased the debt even further by stretching out the payments beyond 2032. Goldman managed to extract $500 million from the Greeks, according to numerous press stories (*Independent,* Friday, July 10, 2015: "Greek Debt Crisis: Goldman Sachs Could Be Sued for Helping Hide Debts When it Joined Euro").

Goldman didn't even blink an eye and went to Athens to sell yet another deal. Goldman Sachs' President Gary Cohen personally traveled to Athens and offered to finance the country's health care system debt, pushing that debt even further into the future. Goldman did not merely make huge fees; it even allegedly placed a bet on the economy of Greece that it would fail based upon its inside information. Goldman is known as "Government Sachs" and has been apparently beyond the reach of any law anywhere. President Papandreou wisely declined Goldman's 2009 debt deal, and this is when Papandreou blew the lid off of what Goldman had done to his country.

Gary Cohen later weaseled his way into the Trump White House and orchestrated the resurrection of Glass Steagall to knock all the commercial banks out of the investment bank business. This left Goldman Sachs (Government Sachs) with just one competitor — Morgan Stanley.

With increasing fear of excessive sovereign debt, lenders demanded higher interest rates from Eurozone states in 2010, with high debt and deficit levels making it harder for these countries to finance their budget deficits when they were faced with overall low economic growth thanks to austerity. Some affected countries raised taxes and slashed expenditures to combat the debt crisis, which only deepened the economic contraction and created social unrest. Several of these countries, including Greece, Portugal, and Ireland had their sovereign debt downgraded to junk status by international credit rating agencies during this European Sovereign Debt Crisis. This undermined the confidence in the Eurozone and the euro itself surviving going forward.

The Greek Debt Crisis instigated by Goldman Sachs allowed the misreporting of Greece's government budget data when it was revealed that there was higher than expected deficit levels. Investor confidence dropped sharply, which resulted in bond spreads rising to unsustainable levels. Fears engulfed the financial markets spreading as a contagion that the fiscal positions and debt levels of all of southern Europe and other Eurozone countries were simply unsustainable.

In early 2010, the developments were reflected in rising spreads on sovereign bond yields between the affected peripheral member states of Greece, Ireland, Portugal, Spain and, most notably Germany. The Greek yield diverged with the spread between Greek 10-year and German 10-year topping out during the 1st quarter of 2012, reaching 138.06.

The price action in the bond markets is where the volatility, which once would have been in the currency market, was forced into the bond markets. This crisis raised the possibility that Greece might leave the European Monetary Union (EMU) entirely to relieve the volatility in the bond markets. The withdrawal of a nation from the EMU suddenly placed the entire European project at risk. Speculation was rampant that Greece might return to using the drachma. Some were predicting that Greece's economy would collapse while others who drew from the US Great Depression argued that a surprise recovery would unfold.

Greece ultimately received several bailouts from the EU and IMF over the following years in exchange for the adoption of EU-mandated austerity measures to cut public spending and raise taxes significantly. The EU crushed the Greeks into a full-blown depression mixed with social unrest. Greece was propelled toward a sovereign default in June 2015. The Greek people voted against a bailout and further EU austerity measures the following month.

The European Financial Stability Facility was replaced by a permanent bailout fund. The European Stability Mechanism (ESM) became effective in July 2012, and the permanent fund assured lenders that the EU would stand behind its members' debts which began to lower the risk of default.

Voting rules in the ESM would allow emergency decisions to be passed with an 85% qualified majority, allowing the EU to act faster. In fact, the ESM rule was a covert means to block Germany's staunch austerity philosophy. In fact, Eurozone countries would lend another €200 billion euros to the IMF from their central banks.

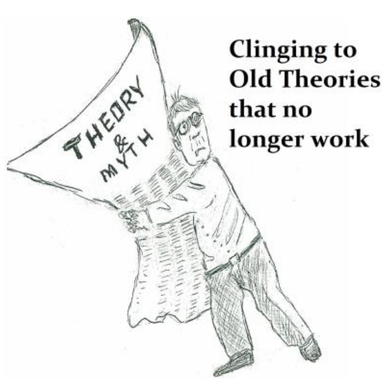
This followed the IMF bailout in May 2010 of Greece, where EU leaders pledged €720 billion euros to prevent the debt crisis from triggering another major financial crash. While this seemed to reduce fears that the euro would not survive, the currency still declined steadily until it reached a temporary low in January 2017 at $1.0341, down from July 2008 high of $1.6036. Europe's austerity policy sent the libor soaring as banks started to panic as they did back in 2008. This time, however, it was not mortgage-backed securities, but European sovereign debt.

Unbeknown to most, the United States and China both intervened after the ECB said it would not rescue Greece. While Europe was squeezing blood out of every Greek citizen, the Chinese came in on a white horse with bucket-loads of investments that economically helped Greece when Europe would not due to its austerity policy. China got a political foothold in Greece.

The smart money realized that the ECB held a lot of sovereign debt. If the Eurozone was going to see sovereign debt defaults, this suddenly made many see that the ECB was not like the Federal Reserve and defaults would have jeopardized its very existence. With the survivability of the ECB also in question, it became obvious that even a partial sovereign debt default among Eurozone members threatened the survivability of the EU itself.

What became obvious behind the curtain was that an uncontrolled sovereign debt default among Eurozone member states could result in, not just a major European recession, but could cause a global depression by contagion much like the 1998 Sovereign Debt Crisis of emerging markets such as Russia. However, when Russia defaulted in 1998, other emerging market countries were thrown into default by a liquidity crisis which spread as a global contagion.

A sovereign debt default of any member within the Eurozone could be devastating to the developed markets. Because of the faulty design of the euro and the failure to consolidate the debts, this means that the risk of a contagion inside the Eurozone was a major structural risk for one default impacts the entire Eurozone. This time, it would not be emerging markets as it was in 1998, but the developed markets that were in danger of default which would then impact all developed economies. Germany, France, and the U.S., who were the major backers of the IMF, suddenly would find themselves unable to support the IMF in such a debt crisis. The entire house of cards would come down far easier than the media or political sectors would dare to even contemplate.



Behind the curtain, the debt rating agencies like Standard & Poor's and Moody's were insisting that the ECB must step up and guarantee all Eurozone members' debts. Germany refused to accept that solution. Germany demanded debtor countries must install its austerity philosophy measures for they continued to cling to their theory from the hyperinflation era.

Indeed, the Eurozone house of cards was seen as high risk. Germany insisted it had to be austerity and that meant reducing expenditures and to putting their fiscal houses in order. Investors worried that austerity measures would only slow any economic rebound, and debtor countries needed that growth to repay their debts. As such, confidence in the Eurozone continued to deteriorate with no end in sight. Germany's austerity philosophy was exactly contrary to the rest of the world and they outright rejected the Keynesian model.

European bank cuts rate

FRANKFURT (AP) – The European Central Bank cut its main interest rate by a quarter point to 1 percent today and is poised to unveil more measures to help boost the 16-nation euro zone economy.

It was the fourth time this year that the Frankfurt-based bank – which sets monetary policy for countries that share the euro – lowered rates, coming on top of cuts in January, March and April.

The bank's last quarter point cut to 1.25 percent in April, however, left markets feeling let down, as a deeper reduction to help the economy back to growth had been expected.

Analysts were looking to bank President Jean-Claude Trichet's news conference for more clues to the bank's outlook and what other steps it might take to support the financial system, such as possible asset purchases or lengthening the term for its credits to banks.

Elsewhere, the Bank of England left its benchmark rate unchanged at 0.5 percent but said it would increase its effort to expand the supply of money in the economy.

Iceland's central bank cut official interest rates by 2.5 percentage points to 13 percent to help the country's collapsed economy today, the third cut this year by the Sedlabanki.

The U.S. Federal Reserve and the Bank of England have taken their benchmark interest rates nearly as low as they will go – the Fed funds rate is in a range between zero and 0.25 percent.

Both the Fed and the Bank of England have also embarked on a policy of expanding the money supply by buying securities from banks, known as quantitative easing.

Associated Press: The Courier Waterloo, Iowa May 7th 2009, Page 18

Because of the Germany austerity philosophy, while the Federal Reserve and the Bank of England engaged in Quantitative Easing, the European Central Bank could not do so for that would amount to funding Eurozone states which was expressly forbidden. The ECB, up until May 2009, only engaged in lowering interest rates. They would not buy the toxic debt from the banks, nor would they buy government debt of the various members.

EUROPEAN CENTRAL BANK

EUROSYSTEM

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PRESS RELEASE

Purchase programme for covered bonds

4 June 2009

Following-up on its decision of 7 May 2009 to purchase euro-denominated covered bonds issued in the euro area, the Governing Council of the European Central Bank (ECB) decided upon the technical modalities today. These modalities are as follows:

- The purchases, for an amount of EUR 60 billion, will be distributed across the euro area and will be carried out by means of direct purchases.
- The purchases will be conducted in both the primary and the secondary markets.
- In order to be eligible for purchase under the programme, covered bonds must:
-
  - be eligible for use as collateral for Eurosystem credit operations;
  - comply with the criteria set out in Article 22(4) of the Directive on undertakings for collective investment in transferable securities (UCITS) or similar safeguards for non-UCITS-compliant covered bonds;
  - have, as a rule, an issue volume of about EUR 500 million or more and, in any case, not lower than EUR 100 million;
  - have, as a rule, been given a minimum rating of AA or equivalent by at least one of the major rating agencies (Fitch, Moody's, S&P or DBRS) and, in any case, not lower than BBB-/Baa3; and
  - have underlying assets that include exposure to private and/or public entities.
- The counterparties eligible to the purchase programme are those eligible for the Eurosystem's credit operations, as well as euro area-based counterparties used by the Eurosystem for the investment of its euro denominated portfolios.
- The purchases will start in July 2009 and are expected to be fully implemented by the end of June 2010 at the latest.

The European Central Bank announced that it would focus on buying "covered bonds," a form of corporate debt, on May 7th, 2009, with about €60 billion over one year. Covered bonds are sold by banks and backed by pools of mortgages. These bonds date back to 18th century Prussia. For many European banks, they are a key source of funding for mortgage lending.

The ECB began its Quantitative Easing by buying these private bonds because there was resistance to buying government bonds by Germany under its austerity philosophy. Therefore, the Covered Bond Purchase Program (CBPP) was intended to stimulate activity in the Eurozone private covered bond market. Under the CBPP, the Eurosystem made outright purchases of covered bonds to the nominal value of €60 billion over the 12-month period from July 6th, 2009 to the end of June 2010, when the program was complete. Over this period, a total of 422 different bond series were purchased.

On March 25th, 2014, Germany's central bank, the Bundesbank, agreed that the ECB could buy loans and other assets from banks to help support the Eurozone economy. This was a radical shift in its stance on the contested policy of Quantitative Easing. The constant lowering of interest rates was having no impact when the Quantitative Easing of the Federal Reserve and the Bank of England produced positive results.

The ECB had cut interest rates to a record low and promised to keep them low for some time, having also flooded the banking system with cheap crisis loans. Nevertheless, the Eurozone economy was inherently weak, and this was the direct result of the structural flaws.

The Bundesbank President Jens Weidmann conceded that the ECB could consider purchasing Eurozone government bonds, or top-rated private sector assets. This altered the bond buying program, which had been consistently criticized by the Bundesbank. Weidmann added that the ECB must maintain high quality standards. The head of the Bundesbank is a member of the ECB's Governing Council which makes those decisions.

Weidmann's predecessor, Axel Weber, resigned in 2011 in protest at the ECB's first government bond purchase program at the height of the Eurozone debt crisis. Weidmann was the only Governing Council member to vote against the OMT in 2012. The Bundesbank remains concerned that the ECB's mandate of preserving price stability may be venturing too far into the realm of financing governments by buying sovereign debt, which was banned under EU law.

On June 12th, 2014, the ECB moved to negative interest rates. It stated that to maintain a functioning money market in which commercial banks lend to each other, the deposit rate was already at 0% and the refinancing rate at 0.25%. Hence a cut in the refinancing rate to 0.15 % meant the deposit rate had to be lowered to −0.10 % in order to maintain this "corridor" spread.

The negative interest rates still had no impact. About six months later on January 22, 2015, in a dramatic change of policy following the new Jackson Hole Consensus in the United States, Mario Draghi announced that the ECB would embark on an "expanded asset purchase program," where €60 billion per month of euro-area bonds from central governments, agencies, and European institutions would be purchased as part of its Quantitative Easing.

EUROPEAN CENTRAL BANK

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PRESS RELEASE

ECB announces expanded asset purchase programme

22 January 2015

- ECB expands purchases to include bonds issued by euro area central governments, agencies and European institutions
- Combined monthly asset purchases to amount to €60 billion
- Purchases intended to be carried out until at least September 2016
- Programme designed to fulfil price stability mandate

The Governing Council of the European Central Bank (ECB) today announced an expanded asset purchase programme. Aimed at fulfilling the ECB's price stability mandate, this programme will see the ECB add the purchase of sovereign bonds to its existing private sector asset purchase programmes in order to address the risks of a too prolonged period of low inflation.

The Governing Council took this decision in a situation in which most indicators of actual and expected inflation in the euro area had drifted towards their historical lows. As potential second-round effects on wage and price-setting threatened to adversely affect medium-term price developments, this situation required a forceful monetary policy response.

Asset purchases provide monetary stimulus to the economy in a context where key ECB interest rates are at their lower bound. They further ease monetary and financial conditions, making access to finance cheaper for firms and households. This tends to support investment and consumption, and ultimately contributes to a return of inflation rates towards 2%.

The programme will encompass the asset-backed securities purchase programme (ABSPP) and the covered bond purchase programme (CBPP3), which were both launched late last year. Combined monthly purchases will amount to €60 billion. They are intended to be carried out until at least September 2016 and in any case until the Governing Council sees a sustained adjustment in the path of inflation that is consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term.

The ECB will buy bonds issued by euro area central governments, agencies and European institutions in the secondary market against central bank money, which the institutions that sold the securities can use to buy other assets and extend credit to the real economy. In both cases, this contributes to an easing of financial conditions.

The programme signals the Governing Council's resolve to meet its objective of price stability in an unprecedented economic and financial environment. The instruments deployed are appropriate in the current circumstances and in full compliance with the EU Treaties.

As regards the additional asset purchases, the Governing Council retains control over all the design features of the programme and the ECB will coordinate the purchases, thereby safeguarding the singleness of the Eurosystem's monetary policy. The Eurosystem will make use of decentralised implementation to mobilise its resources.

With regard to the sharing of hypothetical losses, the Governing Council decided that purchases of securities of European institutions (which will be 12% of the additional asset purchases, and which will be purchased by NCBs) will be subject to loss sharing. The rest of the NCBs' additional asset purchases will not be subject to loss sharing. The ECB will hold 8% of the additional asset purchases. This implies that 20% of the additional asset purchases will be subject to a regime of risk sharing.

Therefore, starting in March 2015, the stimulus was planned to last until September 2016 at the earliest with a total QE of at least €1.1 trillion. Mario Draghi announced the program would continue "until we see a continued adjustment in the path of inflation," referring to the ECB's need to combat the growing threat of deflation across the Eurozone in early 2015.

Then on March 10th, 2016, the ECB increased its monthly bond purchases to €80 billion from €60 billion and started to include corporate bonds under the asset purchasing program as well and announced new ultra-cheap four-year loans to banks.

Consequently, ever since March 2015, the European Central Bank (ECB) has been buying government bonds as well as some corporate bonds in huge volumes, at a rate of €60 billion euros month.

By February 2017, the European Central Bank held more than €1.5 trillion of assets, which it has bought as part of purchases designed to "stimulate" the Eurozone. In late 2016, the ECB announced it would extend purchases at the end of March 2017, but it would at least reduce them from €80bn to €60bn per month.

The scale of these purchases did not merely dominate the prices of bonds in credit markets across Europe from government debt to covered bonds, but it resulted in foreign holders selling their euro bonds back to the ECB and taking their funds to America. The European bond markets were irreparably changed by the ECB as it destroyed the free market in European bonds and altered the risk reflected in prices and yields.

The majority of the ECB's purchases became government bonds, which subsidized the fiscal irresponsibility in the Eurozone by keeping yields artificially low and eliminating any incentive to reduce spending. Investors were eliminated from the markets and they were simply replaced with punters who had no interest in actually holding bonds to maturity. The European bond market was transformed into nothing different than a gold futures contract where nobody actually looks to take delivery. Speculation over future decisions of the ECB began to turn on both yields and the eligibility of different types of debt instruments. In December 2016, the ECB announced it would lift restrictions on buying debt with yields below the Eurozone's deposit rate of minus -0.4%. They were digging the hole deeper and deeper.

When we step back and look at the struggle to save the euro after the 2010–2012 crisis, the Quantitative Easing has merely destroyed the sovereign debt market in Europe. European banks, on average, reduced their holdings of sovereign debt by some 3% over that period.

According to the Bank for International Settlements, Italian banks held 20% of their government bonds which was one of the highest ratios in the world. Spanish banks saw probably the most drastic reduction in holding government bonds in the Eurozone. In 2014, the Spanish banks held 30% of government bonds. That collapsed to just below 17% by the end of 2018. Private investors, both domestic and non-residential, took advantage of the ECB bond buying program and sold much of the holdings to the ECB. That was a major shift in capital which then found its way to the United States share market.

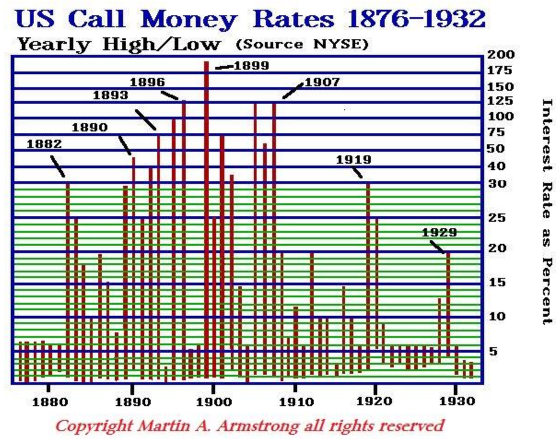
Once again, this failure to grasp the global economy and myopic focus only on the domestic economy has defeated the entire theory of stimulating the economy by purchasing government debt. This assumption that the cash would remain within the domestic economy has been a fool's game. They just never seem to grasp that this is a global economy. This combined with the austerity philosophy of Germany has undermined the entire structure of the EU and rendered the Eurozone an unsustainable entity long-term.

Manipulating the Short-Term Interest Rate

The United States Federal Reserve has lost control of the one interest rate it traditionally could control — short-term rates. During the Quantitative Easing (QE) of 2007-2009, many claimed analysts did not actually understand the reasoning behind the QE maneuver. They claimed this was increasing the money supply and therefore it would produce inflation. The central banks actually held that same view while the goldbugs said it would be hyperinflation.

The Federal Reserve has set the sort-term rates, but not the long-term. The QE of the 2007-2009 Crisis was all about buying in 30-year bonds to manipulate the long-term rates. This time, they have lost control of the short-term. This means the Fed is actually fighting for its life. If it can no longer control the short-term, then we are looking at the Mother of all Financial Crises for we are dealing with the collapse in the power, respect, and belief in central banks as a whole.

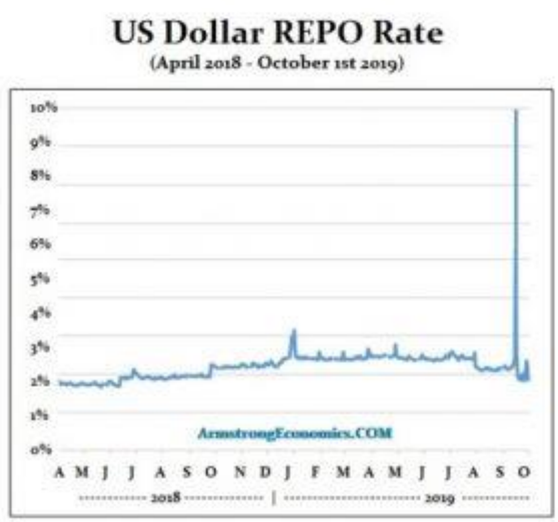
Consequently, the Fed is buying $60 billion of Treasury bills per month for an entirely different purpose. These are usually 90-day paper or less, so they expire quickly. This is not expanding the balance sheet of the Fed in a QE manner. They



are not trying to support a bank or to "stimulate" the economy. They are trying to prevent short-term rates from exploding. If the Fed does not step in and banks stop lending to each other for fear of undisclosed counterparty risks, then interest rates could swing dramatically higher to 25% or higher in a move for emergency cash overnight. The historical high on such rates prior to the creation of the Federal Reserve in 1913 took place in 1899 when such rates reached 200%.

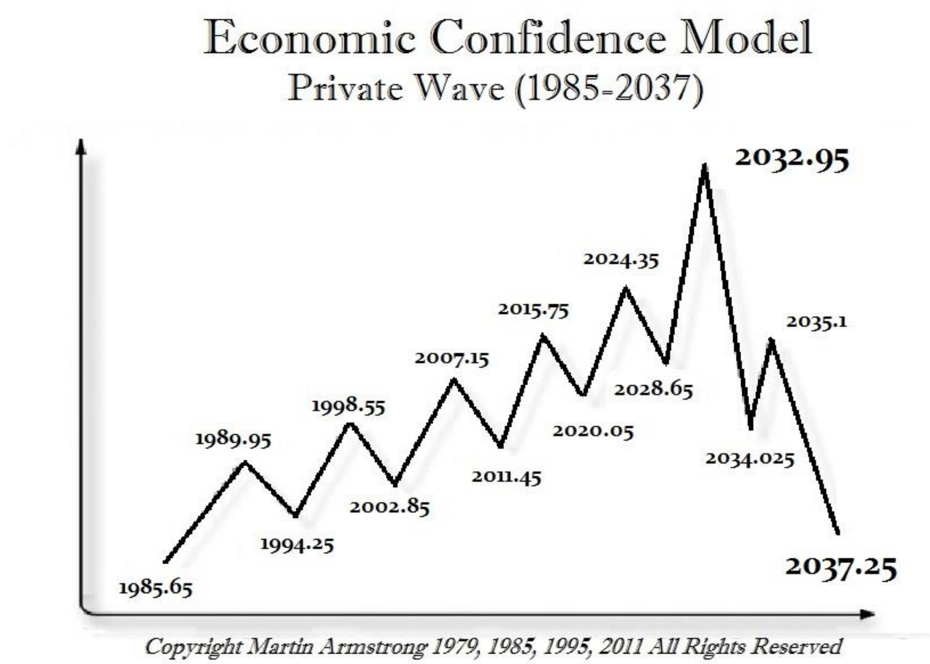
This is the crisis. Banks no longer trust banks because nobody knows the contagion that could engulf the entire world coming out of Europe. We must understand the stark difference here. The 2007-2009 QE was an attempt to "stimulate" the economy by encouraging banks to lend, which it failed to accomplish. Here the Fed is trying to prevent repo rates from rising to 10% or beyond again because it is defending its own power to control short-term rates. The fact that the banks do not trust banks has compelled the Fed to step in and be the middleman here to prevent rates from rising dramatically.

We are witnessing the Fed trying to maintain control over the benchmark short-term interest rate it uses to guide monetary policy. They are not "stimulating" the economy, bailing out banks, buying US debt because others will not, or anything of the like. Buying T-Bills is short-term, not long-term. They are trying to artificially prevent short-term rates from rising, which our model shows in underway.



The crisis has nothing to do with the economy domestically and it is not Quantitative Easing to stimulate the economy by buying in long-term debt. They are trying to keep short-term rates from rising which is being instigated by an entirely different type of financial crisis that has never before been witnessed.

The Crisis in Democracy – The Unelected Governments



On April 15, 1987, we published a report entitled *Crisis in Democracy*. What was appearing at the beginning of this Private Wave was that government would lose power. During such wave, government becomes more authoritative. Indeed, at the beginning of this Private Wave, we began with the formation of the G5 at the Plaza Accord who was intent upon manipulating the US dollar lower for trade purposes.

We wrote in that report:

> "The future will spawn a crisis of a different sort indeed and its forthcoming can be read easily upon the chart patterns of bonds, stocks, gold and clearly in foreign exchange. The forthcoming crisis will be a Crisis in Democracy for to control our financial destiny in a more orderly fashion, we will give up much of our rights to privacy in our personal financial affairs."

A Crisis in Democracy by Martin A. Armstrong, ©Copyright April 15, 1987

We also warned at back in 1985 that from the pi target in that wave 2017.05 (1985.65 + 31.4 years) we would see the first potential for a third party president in the United States. Our computer projected Trump as the winner long before the candidate was even selected. Our computer also projected at the start of this 51.6-year wave (1985.65) that by 2016 the door would open for a possible third party candidate. That meant 2107.05 which was Wednesday, January 18, 2017. Trump was inaugurated on Saturday, January 21, 2017, 12:00 AM GMT+7. So we were close but off by 2.5 days for a forecast made 31.4 years prior (1985.65 + 31.4 = 2017.05).

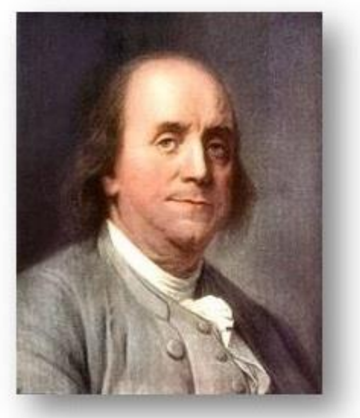
We also warned that the turning point of 2015.75, September 29th, 2015, was the peak in government.

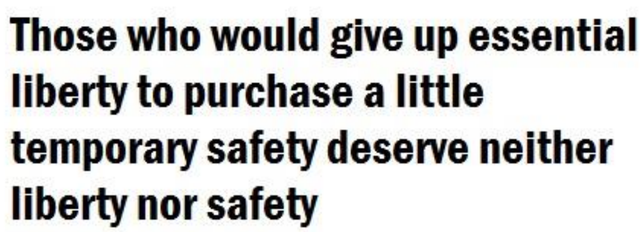
> "This is confirming the change in trend that we see with 2015.75. It is not a monumental crash in stocks, nor is it the end of the world with the blood moon. This is the peak in government. As time begins to move forward, you will look back at this turning point as rather significant."

Indeed, the 2015.75 target was the half-way mark in this 51.6-year wave and the second wave would witness the more pronounced collapse in the confidence of government. This became self-evident with the election of Donald Trump in 2016. We also forecast that Brexit would take place in Britain. Our computer was showing this trend was indeed global in nature.

Many people have simply been in disbelief as to how we can deliver such a forecast decades in advance. What they have failed to understand is that forecasting the long-term trends is far easier than short-term. This may sound counter-intuitive, but the reason is simply that the major trend is set in motion and will reach its conclusion in spite of the short-term noise. The market can rally and fall within a set trading bandwith. However, nobody can change the long-term trend. Hence, predicting the long-term is far easier than the noise that churns out headlines every day.

History is the guidebook to the future for it records how people respond to certain types of events. History simply repeats because the self-interest produces the same result when confronted with similar actions. And as for politicians, they all have the same game book no matter what country or century we look at.



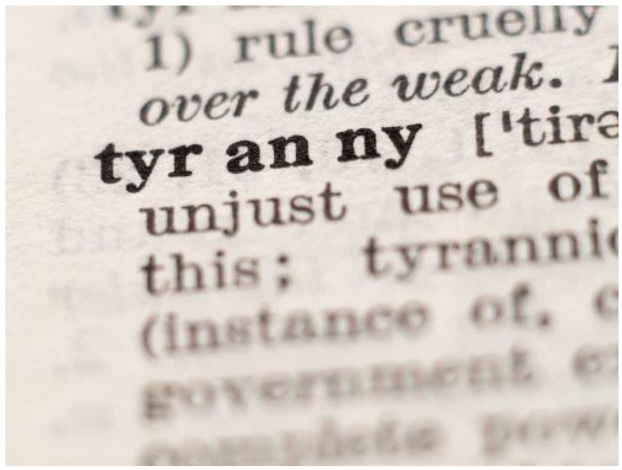


Benjamin Franklin
(1706-1790)

Governments always raise issues to a hysterical level of urgency, for then people act irresponsibly and will surrender their rights for what they are told is their own security. Politicians will routinely call in children when rights are being taken to pretend it is for their security. They will always portray themselves as the great savior of the people. There is always the same play book.

Trajan. AD 98-117
AU Aureus (18mm, 7.18 g)
Rome mint. Struck 111AD Trajan extending right hand towards boy and girl

The Roman Emperor Trajan introduced the *Alimenta Italia* to buy support by feeding and educating orphans. He was concerned about his acceptance and used support of Rome's most destitute of citizens because he was the first emperor who was born in Spain and was not of Italian parents.



The problem emerging from Europe is that the very structure of the new federal government was cleverly crafted to ensure they did not stand for election. The people could only elect members of Parliament, but that is just for show since the Parliament neither introduces legislation nor do they vote on anything. The people have absolutely no power to do anything, and that includes electing the leaders of the European Commission. The EU has assumed the people are too stupid to know what is best for them so they are just denied the right to be heard.

The EU is rapidly growing and expanding only according to its self-interests of federalizing Europe. There is absolutely no election process so there is no possible way for the people to object or change the direction of government through any democratic process whatsoever. The very structure has left only one method to change the direction of government — civil revolution.

The EU is operating under anti-democratic principles and was designed assuming the Great Unwashed should not be heard. This is why most states never allowed the people to vote to join the euro, as was the case in Germany. The EU has rejected all democratic institutions from the outset. This is the next step in the evolutionary process of government power, much like the rise of communism claiming this is for the benefit of the people. There is no actual social contract either implied or specified. It is all about government maintaining control and modern tyranny.

The Troika is made up of the unelected heads of the IMF. Christine Legarde, unelected head of ECB Mario Draghi, and the unelected EU President Jean–Claude Juncker became the living breathing example of pure modern tyranny for it is a three–part commission that was in charge of monitoring the euro debt crisis and ending the deflation. They have agreed to policies from negative interest rates to bail–ins of banks, as took place in Cyprus. None of these policies of the Troika have ever been submitted to the people. They cannot be removed from power for they never stand for election. This is pure economic tyrannical dictatorial power.

Legislation is not proposed by the elected member to Parliament. The legislation comes from the unelected European Commission. Thereafter, they obtain the consent of the Council and Parliament. Thus Parliament has the legal power to accept or reject any proposal but no legal mechanism exists for proposing amendments. The structural design of the EU was intentionally created to provide the image of democracy while denying the Parliament any authority to create or even amend legislation.

The Fate of the EU & Euro

The most sinister aspect of the European Union has been the intentional design structure that has sought to eliminate any democratic process. They assumed the people were too stupid to understand that the political elite was really trying to forge the United States of Europe and institutionalize a federalized Europe with one government.

Brussels is seeking to consolidate power by sheer force, demanding with the stroke of a pen the surrender of culture, creating a one-size-fits-all approach in the most anti-democratic system since Stalin and Mao. Yet, ask anyone within the European continent what they are. The response is German, English, French, Italian, Greek, Spanish, even Swiss or Dutch. Nobody responds, "I am European." That answers the question as to the distinction between Europe and America. America was the melting pot, and once everyone spoke the same language they intermarried which remains a minority in Europe. Therefore, Margaret Thatcher was opposed to the creation of the euro and

sought to keep Britain out of such a monetary union.

Of course, from the outset, European leaders denied that there was an agenda to federalize Europe. They swore that they were just creating only a single currency to compete with the dollar. The commission charged with formulating the new single currency attended our World Economic Conference. I warned that they had to consolidate the debts to create a single currency to compete against the dollar, for big money needed a place to park capital. I was told back then that the European population would see that as a bailout for some countries. All they wanted was to get the single currency through first, and then they would deal with the debt later. The whole agenda was to first federalize Europe and then sneak other agendas through as the people are always complacent. Chancellor Kohl denied the German people a right to vote on even joining the euro.

The fate of the euro has remained unchanged from its inception. At the same time, there were members of the central banks who were against the euro and did not want to surrender their power to a central authority, which took place under the European Central Bank (ECB).

The head of the ECB is appointed for a seven-year term and thus does not stand for election and rules over all central bank policies within Europe. The great distinction between the Fed and the ECB remains the fact that the Fed does not compete with central banks of 50 states, whereas each member state in the Eurozone retains its central bank.

Amazingly, Mario Draghi stated publicly at a press conference in July 2016, that there was a change in policy because the ECB rule prevents them from buying negative yielding bonds. With German 10-year moving negative, that meant Draghi could not buy anything from Germany. Draghi came out and said that if necessary he will use all "available instruments." This meant private corporate debt as well, but he has bought the distressed corporate debt, which again is not stimulating the economy, but merely keeping it on life support.

The International Monetary Fund (IMF) during September 2016 warned at the G20 summit in Hangzhou, China, that in the face of crises, the refusal to reform will lead to economic weakness in the global economy. "The latest data show subdued activity, less growth in trade and a very low inflation, suggesting an even weaker global economic growth this year," the IMF told G20 leaders.

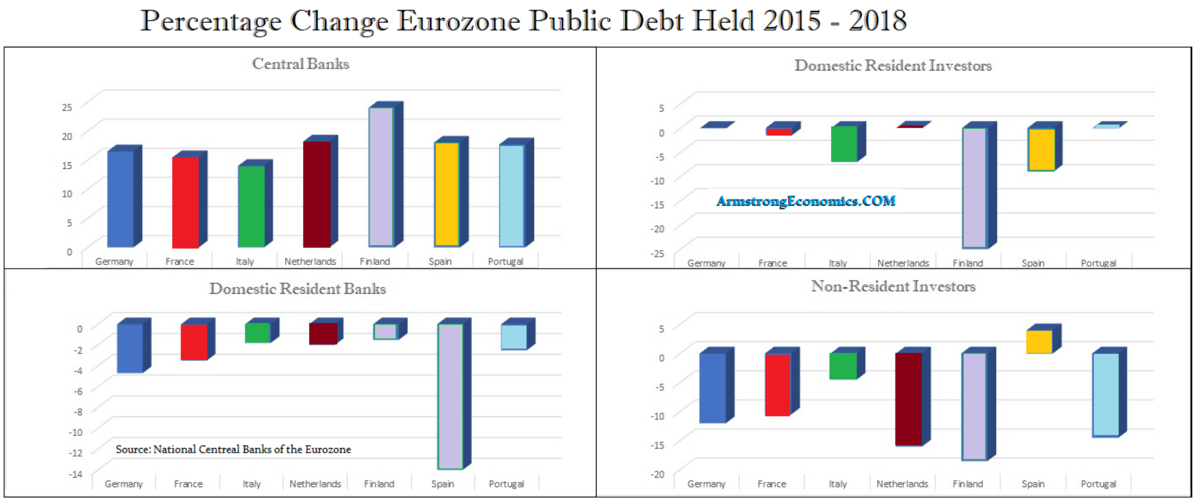
Indeed, 2016 came in as the fifth consecutive year where global growth fell below the average of 3.7%, which prevailed between 1990 and 2007. The IMF said, "Without strong political countermeasures the world could suffer a disappointing growth." Christine Lagarde told world leaders,"Even in the longer term the outlook remains disappointing."

When we look at the GDP growth rate on a quarterly basis since 1995, we can see even technically the peak in the rebound from the 2009 low took place in 2015, and that merely tested the former uptrend line from beneath. On a pure technical perspective, this is a very weak chart pattern and the risk of dropping back to negative growth remains a possibility.

The European Central Bank (ECB) is dangerously trapped holding 40% of Eurozone government debt. They have bought in bonds under the theory that this will stimulate the economy by injecting cash. However, the banks are hoarding the cash because a stiff wind will blow them over. If the money injected does not reach the consumer, it is incapable of stimulating anything. Moreover, they totally fail to understand that the empirical level of interest rates means absolutely nothing. It is the net difference between the interest rates and the future expectation of profit that matters. If you think you will double your money, you will pay 25% rates of interest. If you do not see 1% in possible profits, you will not pay even a 0.5% interest rate.

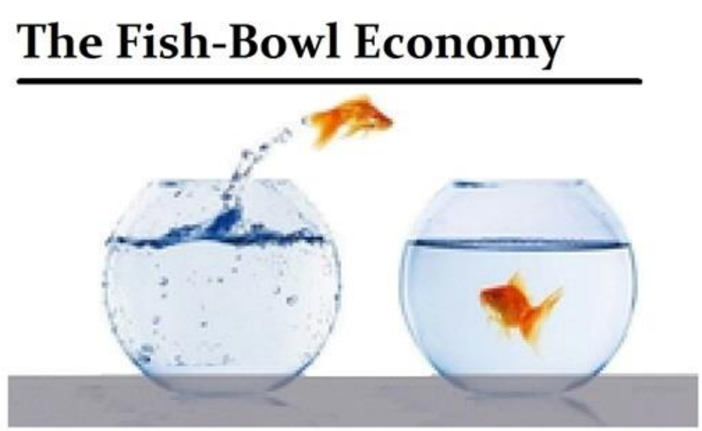
At the end of 2018, the ECB's bond buying program showed that after 45 months, it had injected €2.6 trillion of liquidity into the system. The ECB's balance sheet reflected €1.9 trillion of government bonds it had purchased via the national central banks. This represented 90% of the bonds issued by European governments, which was a staggering level demonstrating that indeed the ECB has only managed to keep the Eurozone governments on life support. The interest rates were artificial, and worst of all, the ECB singlehandedly destroyed the open market for government debt in the Eurozone. Compared to the United States, foreign governments and investors held 30%, individuals, banks, and investors held 15%, and the Federal Reserve held 12%. The balance was interagency holdings like Social Security. This presented a stark difference between the ECB and the Federal Reserve.

In reality, Quantitative Easing actually shifted sovereign risk from the private sector (both domestic and foreign) to the public sector. This is why I have stated that the ECB has destroyed the European bond markets, and this would take a long time to rebalance if that is even possible. The Italians have no solution for their debt. Greece has been in a nine-year depression. The prospect of unemployment rates improving is about zero. While the German government refuses to concede loans to southern Europe, privately, Germany has lent a lot out in financing it produces to sell to the rest of Europe.



When we focus on the shift in who holds the public debt in the Eurozone, this chart illustrates what we have been saying. The crisis here is that the ECB has destroyed the European bond market. Domestic banks, domestic investors, and foreign investors have all sharply reduced their holdings of European debt. This has been displaced by the ECB purchases which reached 90% of new issues.

On average, the holdings of Eurozone public debt by central banks was just 4% in 2010. The ECB intended to shift debt holdings among national banking sectors to stimulate the economy by reducing their holdings of government debt, presuming they would lend more to the private sector. This clearly broke the link between sovereign debt holdings and banks, which the ECB assumed was the main contributor to the European Sovereign Debt Crisis 2010–2012 that exposed the structural flaw that the monetary union lacked a fiscal union.



The entire theory of Quantitative Easing was based upon an unrealistic view of the economy. They attempt to manage it as if this were indeed a fish bowl. There is never consideration about how capital migrates around the world. Indeed, it can jump to another economy in the blink of an eye or domestic policies can attract or deflect foreign capital inflows.

Foreign investors simply reduced their holdings of Eurozone sovereign debt, as has been the case among worldwide central banks. The negative interest rates have acted as a deterrent from the euro being used as a reserve currency within the global economy. Indeed, from a broad perspective, the foreign investors were the primary sellers of Eurozone debt to the ECB. This contributed to the further decline in the euro as they took their money to friendlier markets.

I have explained how the world accounting system is seriously flawed. A foreigner buying a government bond shows the money going through the capital account. Any interest it receives in return is reflected in the current account, which many wrongly call the trade account.

We have the same problem in the Eurozone despite the fact that it has pretended to be a single European economy. If a foreign investor sells an Italian government bond to the Bank of Italy, this goes through what is called the TARGET2 payment system. If the account was at the Deutsche Bundesbank, then the transaction will be accounted for as if it had occurred between the Italy and the German central banks. This will then distort the numbers since it will appear as a capital inflow towards Germany, when in fact the true party was located outside the Eurozone area. The accounting system of pre-euro is still reflected because there was no true consolidation of debts or the economy.

This attempt to stimulate the economy by increasing the money supply has simply failed. The Sovereign Debt Crisis instigated by the Greek crisis in 2010 exposed the true crisis that there was more required than just a monetary union. The failure to consolidate the debts illustrates the lack of a fiscal union. Monetary policy alone by the ECB simply has failed to repair the Eurozone economy.

The ECB finally moved to Quantitative Easing using government debt in 2014 only after the Bundesbank approved. Thus, the ECB began to finally move with the Keynesian model only six years after the Federal Reserve. It then sought to increase the money supply with Quantitative Easing against the austerity policies of Germany. This was when the ECB moved to negative interest rates during 2014 to punish savers and consumers for not spending money that never reached their pockets to start with.

Negative rates had a side effect the ECB never considered. First, it acted as a deterrent for other central banks to retain the euro as a reserve currency. Then it also led to creating the incentive to hoard cash outside the banking system. To combat that, Draghi and others began to consider eliminating cash. They used a slogan that was first articulated in Australia, "Cash is for Criminals." In truth, negative rates simply became a tax on money.

Then we have the problem that the ECB became trapped for it lacked the ability to create elastic money. It found it could not simply reverse Quantitative Easing operations by reselling the debt back into the system. What was originally seen as a temporary measure became permanent.

Elastic Money & the Fed Coup

The entire idea of creating an elastic money supply that would contract when the crisis was over became impossible for the ECB. That policy was first developed in the United States during the 19th century and employed by the Financial Clearing Houses and not government, which was much different. When the Federal Reserve was created, it was given the authority to create elastic money to purchase short-term corporate paper when banks were unable to lend. This would help to maintain the economy and reduce the natural tendency to start laying off workers.

UNCLE SAM'S NEED OF AN ELASTIC CURRENCY

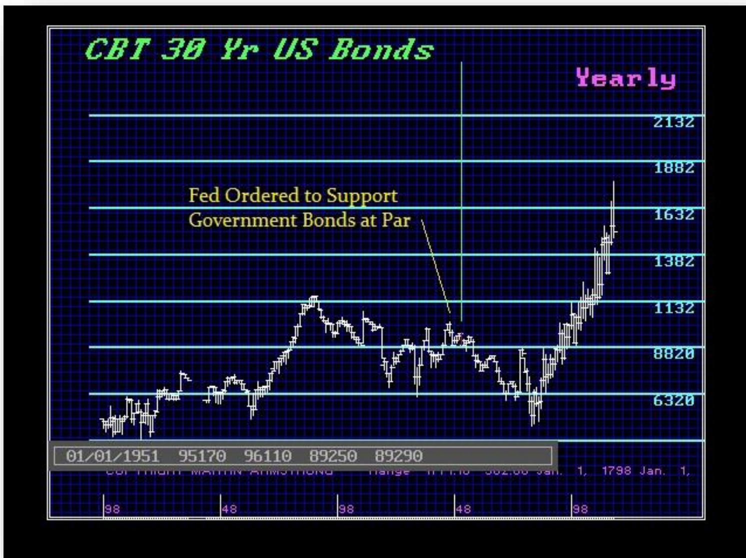
PRESIDENT ROOSEVELT: "You see, those galluses ought to have rubber in them, so that when Uncle Sam stoops to move the sheaf there won't be much strain on the buttons."

From the *Pioneer Press* (St. Paul)

Once World War I came into play, the government ordered the Fed to buy government bonds for the war. They never restored the Fed to its original design. Private corporations pay off their debt so the money supply would naturally contract. Government borrows continuously and thus its debt will never contract, defeating the very idea of an elastic money supply to aid economic recessions. Altering the structure of the Federal Reserve to hold government debt instead of private seriously undermined the entire elastic money authority.

1942 Accord

During the Great Depression, Franklin Roosevelt (FDR) took control of the Fed away from the banks, which had been independent up until this period in time. It did not take long to abuse that power. It was during April 1942, when the Department of the Treasury requested the Federal Reserve formally commit to maintaining a low interest-rate peg of 3/8% on short-term Treasury bills to fund the war.



The Fed also implicitly capped the rate on long-term Treasury bonds at 2.5%. This became known as the "peg" with the goal of stabilizing the securities market and allowing the federal government to engage in cheaper debt to finance World War II, which the United States had entered in December 1941.

At the time, in order for the Fed to maintain the peg, it was ordered to give up control of the size of its portfolio as well as the money stock. That is also what has happened today with Quantitative Easing among all central banks. Frankly, the Fed back then maintained the low interest rate by buying large amounts of government securities, which also increased the money supply domestically at the time. Because the Fed was committed to a specific rate by the peg, it was compelled to continue buying securities even if the members of the Federal Open Market Committee (FOMC) disagreed.

After the war, politicians were afraid a new depression would emerge as they always fight the last war. They ordered the Fed to maintain the peg even after 1945. The United States entered the Korean War in June 1950. The problem was inflation, not deflation. The FOMC of the Fed argued strongly that the continuation of the peg would lead to excessive inflation. A real confrontation with the politicians was brewing all year and they were opposed by the Treasury who naturally wanted to keep borrowing at cheap rates for its own expenditures as we will see today.

Harry S. Truman (1884 – 1972)
33rd President of the United States (1945 – 1953)

The 1951 Fed Coup

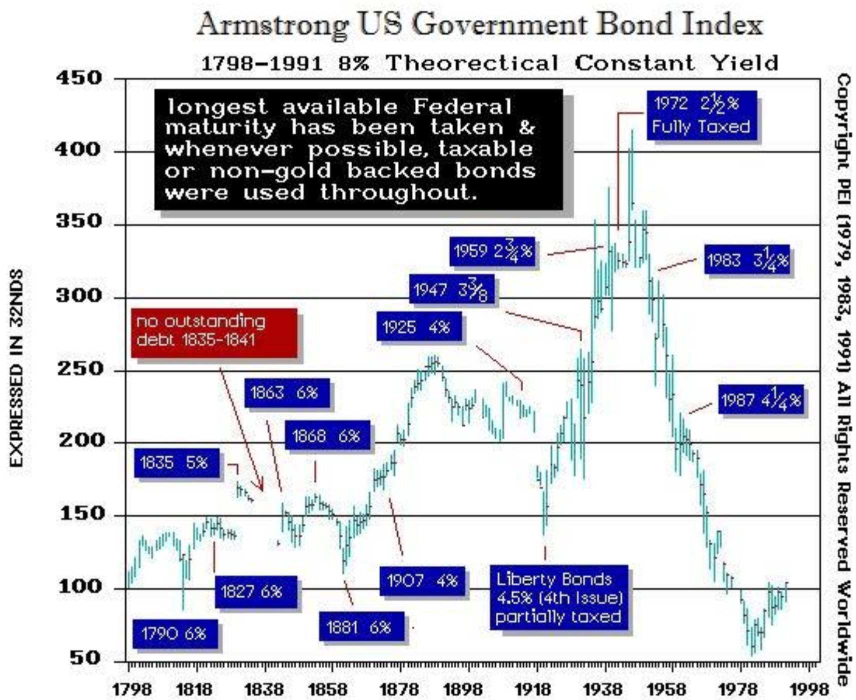
Everything exploded by February 1951. Inflation had soared to 21%. As the Korean War intensified, the Fed faced the possibility of having to monetize a substantial issuance of new government debt to fund that war. This only intensified inflation. Nevertheless, Harry S. Truman became president in 1945 and it was his administration that continued to urge the Fed to maintain the peg.

The financial crisis erupted into a major conflict when Truman invited the entire FOMC to a meeting at the White House. Truman then issued a statement saying that the FOMC had "pledged its support to President Truman to maintain the stability of Government securities as long as the emergency lasts." In reality, the FOMC had made no such pledge. Conflicting stories began to appear about the dispute in the press. The Fed then made an unprecedented move. They released the minutes of the FOMC's meeting with the president.

The conflict erupted in full view. The Fed revolted against the politicians. Shortly thereafter, the Fed informed the Treasury that as of February 19, 1951, it would no longer "maintain the existing situation." The Treasury was caught in a crisis for it needed to refund existing debt and issue new debt, which is a situation all governments are still in today. They never pay off debt, they simply roll forever.

The government had no choice but to negotiate a compromise under which the Fed would continue to support the price of five-year notes for a short time, but after that the bond market would be on its own. It was on March 4, 1951, when the Treasury and the Fed issued a statement saying they had:

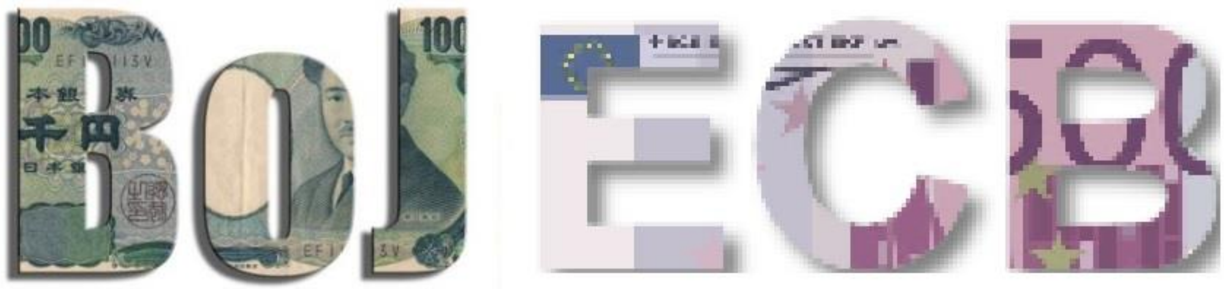
> "[R]eached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose and to assure the successful financing of the government's requirements and, at the same time, to minimize monetization of the public debt."



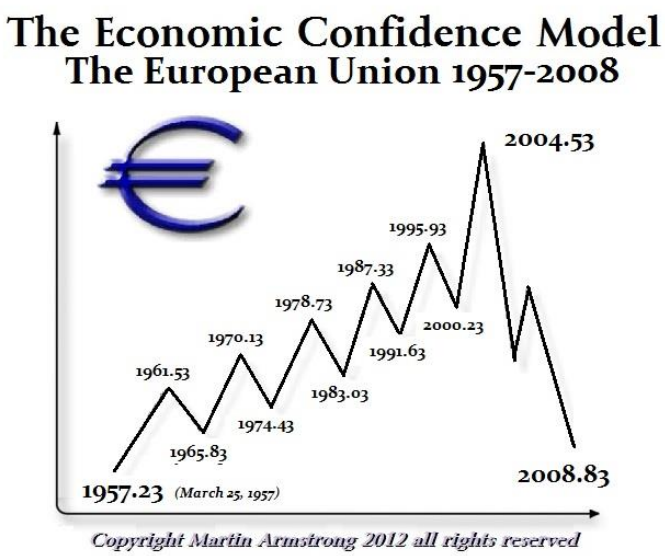
It was this accord that created a free market in government securities. The likelihood that government debt becomes extinct does not appear before 2023. We can see that the bond market began to crash as interest rates were at last free to move after 1951 (note the blue late is the issue date used to create the perpetual contract). This is the most likely outcome of the voluntary Quantitative Easing that is really a critical issue more so in Europe and Japan and less at the Fed.

Necessarium Captionem

This time, the central banks have created their own *Necessarium Captionem* (unescapable trap) with Quantitative Easing. They cannot sell the debt they have bought. The Federal Reserve at least announced it would allow its debt holding to simply expire. The European Central Bank (ECB) has to concede that current debt that matures would have to be reinvested. Therefore, we are looking at a crisis where debt holdings of the ECB and the Bank of Japan must continuously roll. The ECB holds more than 40% of the government debt for the whole of Europe and has been purchasing 90% of new debt issues. Once all of this debt matures, they cannot allow it to go to the market once again. Interest rates will rise dramatically.



The ECB and the Bank of Japan have put at risk their very existence. We are looking at a deflationary impact by default, which can wipe out the central banks and end this modern age of Interventionism. The entire theory of elastic money was that it would contract after the crisis. The inability of the Bank of Japan and the ECB to stop buying their respective debts for fear that interest rates will rise dramatically has brought their entire existence to a critical point of long-term viability. The age of modern Keynesianism (interventionism) is rapidly coming to an end. There will need to be some serious reconciliations with reality. In the face of rising socialistic demands, we must wonder if this is also the culmination of political unrest.



Eurozone countries under Maastricht must continuously reduce government debt as long as it is above 60% of GDP. Only a handful of countries meet this criterion at this moment in time. The Eurozone average debt to GDP is almost 87%, with projections showing it will never decline below 60% between now and 2032.

The ECB has already purchased more than 2.5 trillion euros worth of debt as part of its Quantitative Easing scheme. However, they are approaching 2 trillion in government debt which excludes the bonds that are corporate debt, supranational bonds, covered bonds, and asset-backed securities. While there are suggestions that the ECB should now start to buy shares of European public companies, there is also an obscure clause in government bond contracts that the ECB is taking under consideration as a means to exceed the 33 1/3% limitation of a member state's debt.

The European Central Bank has a clever trick up its sleeve to exceed this limitation and launch a fresh stimulus by allowing even more government debt. If any entity exceeds 33 1/3% of a member state's debt, it then has the right to object to any restructuring of default. This is called a "blocking minority," and in the event a country applies for a debt restructuring, its bondholders would then have a right to vote on it.

This limit presents a problem for the ECB. It is already close to the threshold in the case of Finland, the Netherlands, and Portugal. This clever trick means that the Eurozone's 19 national central banks must surrender this right. This would be accomplished through the clause known as "disenfranchisement" that surrenders their voting rights. Using this clever scheme, the ECB and the national central banks could exceed this limitation individually.

This is what the ECB has hinted at by saying they still have additional "flexibility" within its mandate to expand Quantitative Easing. The problem this presents is that the ECB will never be able to allow its debt holdings to mature. The resale of debt in addition to new debt would be vast, and interest rates would explode in a real free market.

Immediately, the ECB holds the bonds until they mature and then reinvests the cash back into debt issued by the same country. The flexibility is limited to maturity. At some point in the future, the marketplace will realize that the ECB cannot shrink its balance sheet because its artificially low interest rates precludes returning to the free market where rates will be substantially higher. This reflects the Sovereign Debt Crisis and the future risk.

Some argue that the ECB could just announce it is accepting a default on all current debt that it holds. This would be illegal under its structural decree. The ECB is prohibited by law from providing financing to governments. It can also not be instructed by member states to default on their own debt. The only thing a member state can do is exit the Eurozone and default on its debt in euros held by the ECB. Some suggest they could exit the euro and then declare that the old debt has a reduced value as denominated in the new currency. Simply promise to redeem the debt in 50 or 100 years at par and then there is no default.

Many argue that under Quantitative Easing, the ECB is already financing governments by buying their debt. This has been a very technical definition of Quantitative Easing. Germany has challenged the ECB over this very question. Since the ECB can buy no more than one-third of a country's bonds, this is accepted as a monetary policy tool aimed at reducing interest rates and "stimulating" the economy. Since governments are still required to service their debt and the ECB has made profits on its earliest bond purchases in price and interest payments, this profit is then paid out to its shareholders who are the individual national central banks. Hence, the argument is that the profits are returned to the state governments and that means they are not directly financing the member state governments. Therefore, if you borrow $100 and somehow invest that money, it negates the idea that it is a loan and the bank is instead injecting cash into your investment. It is an interesting theory that would not be recognized in the real world.

Consequently, the entire idea of creating an elastic money supply that would contract when the crisis was over became impossible for the ECB. The ECB is unable to sell back the debt it has previously purchased and is compelled to constantly roll what it has with no hope of reducing its balance sheet. The Theory of elastic money simply does not apply to the ECB.

Shifting Global Economy

The global economy is experiencing a significant shift, which is driven mainly by the rising tensions in trade and the realization that the old world mercantilist economy is coming to an end. The emerging markets, which include China, are shifting its reliance upon the West (Europe & North America) and developing their own economies. This shift is underway, but it will take some time to complete – 2032.

The German mercantilist economic model became a national economic policy that is designed to maximize the exports and minimize imports. This policy's objective to reduce a possible current account deficit and create a current account surplus really began during the 16th century. Mercantilism policy was also aimed at accumulating monetary reserves as a result of a positive balance of trade. History stands as a witness that such policies often lead to war and motivate colonial expansion. This has been the primary model still used by Germany, imposed by austerity, and has resulted in German citizens having less net worth than Italians.

Mercantilism became dominant in Europe during the 16th century and continued to expand up to World War I in the early 20th century. It declined and was replaced with socialism post World War I, which intensified following World War II. Mercantilism began gradually and was replaced by interventionism under Keynesianism. Post–Great Depression, Keynesianism promoted government regulation of a nation's economy for the purpose of enhancing state power at the expense of rival national powers. High tariffs, especially on manufactured goods, were an almost universal feature of mercantilist policy. It was not until the early 20th century when tariffs began to be viewed as a tax on consumer spending.

Because protectionism was blamed for the Great Depression, this helped to replace mercantilism with interventionism. This opened the door to the establishment of the World Trade Organization to reduce tariffs globally. Some have still argued that manufacturing has been lost to foreign trade, arguing that foreign labor was cheaper. Governments ignored the rise in taxation as playing any role in shifting manufacturing overseas. Under this new age of neomercantilism, barriers to trade have reappeared in a greater role of importance.

There is a shift in this new order of the world economy. There is a global shift underway within the main emerging markets from external demand to domestic demand. We are also observing a shift from investment to consumption in the West as well as the shift from manufacturing to services inspired by taxation.

As the West grapples with the shift in the economy of China from external demand to domestic demand, they are relying less on global trade and supply chains to boost their economic growth that is shifting domestically. China has looked closely at the economic model of the United States which allows the growth of a consumer market that has supported the entire world, including Germany which is frozen in mercantilism. China has learned from comparing the US and German economies and opted to develop its domestic consumer market. This shift will impact Germany and Europe as a whole far greater than the United States. However, the emergence of world trade conflicts is disrupting even the neomercantilism economic models. This presents a far more significant risk to Germany as it clings to its mercantilist philosophy.

World trade is being reordered as new technologies are also disrupting the conventional service segments. People have turned to online shopping which has reduced jobs in the service community. Supply chains and workplace organizations are being altered and there are potential new risks when companies are unable to adopt technology changes.

The entire creation of the euro was supposed to be better for Germany by reducing foreign exchange risk for its sales within Europe. Its companies fund consumer purchases, so moving to the euro reduced FX risk for German manufacturers selling into the European marketplace. The Eurozone must change to survive. That is unlikely. They must suffer the ravages of economic decline before they concede they must change from their mercantilist philosophy. This is part of the turning point in 2032 and the shift to Asia.

The Deutsche Bank Raid

Deutsche Bank's headquarters in Frankfurt, Germany, was raided by police for the second time in less than a year in September 2019. That's not the sort of thing that inspires confidence among depositors to keep their money in your bank.

Deutsche Bank has been a constant headache for the U.S. financial system because it is heavily intertwined via derivatives with the big banks on Wall Street, including Goldman Sachs, Morgan Stanley, JPMorgan Chase, Citigroup, and Bank of America. It has become the dark cloud on the horizon in the same way Citigroup cast a negative cloud in the early days of the financial crisis of 2008. Indeed, Citigroup's stock eventually fell to 99 cents and the bank received the largest taxpayer/Federal Reserve bailout in U.S. history. The Fed alone secretly pumped $2.5 trillion in revolving loans into Citigroup from December 2007 to the middle of 2010 to save the bank.

The latest raid at Deutsche Bank occurred on September 24 and 25 and was related to the $220 billion money laundering probe of Danske Bank, which is Denmark's largest lender.

Deutsche Bank served as a correspondent bank to Danske's Estonia branch where the laundering was alleged to have occurred. The government raided Deutsche Bank rather than requesting documents. Obviously, there was some concern that they might not turn over documents.

Interestingly, the body of Aivar Rehe, who previously ran the Estonia business of Danske Bank and left in 2015, was discovered by police in Estonia. Rehe had been questioned by prosecutors and was considered a key witness in the money laundering probe. His death is being called an apparent suicide by the European media. It is amazing that anyone who can implicate the big banks seems to always commit suicide.

On Tuesday, September 24, the day the police raid began at Deutsche Bank, the Federal Reserve of New York offered $30 billion in 14-day emergency term loans and had demands for more than twice that amount. That led the New York Fed to increase its subsequent 14-day term loans from $30 billion to $60 billion later in the week. The Fed's overnight repo loans were also increased from $75 billion per day to $100 billion per day.

The government authorities are more like a bull in a china shop. Their seal to get their hands on $220 million was done by calling it money laundering and thus subject to confiscation. They had no regard for the confidence in Europe's biggest bank or what they were doing in the first place. Deutsche Bank has been under siege for many reasons, but $220 million in money laundering against a derivative book of more than $50 trillion in derivatives presents systemic risk throughout the global financial system. These idiots set off a crisis in confidence that has been quite profound around the entire world.

A Pending Deutsche Bank Moment?

The Repo Crisis seems to be something the mainstream press will not touch, and the stories being spun are anything but what is happening. The elephant in the room that they are pretending not to see is the derivative book of Deutsche Bank, which nobody seems to understand. What we are witnessing is the unraveling of globalization as many fear a return of the 1998 Liquidity Crisis with Long-Term Capital Management combined with the Repo Crisis of 2007-2009 which took down Lehman Brothers.

The US bailed out the banks during the 2007-2009 Crisis taking the toxic debt out of the domestic banks, which actually allowed them to recover. In Europe, because Germany's rejection of consolidating debts of member states, the European Central Bank (ECB) could not bailout any banks. In October 2016, Chancellor Angela Merkel publicly made it clear that Germany would not bailout Deutsche Bank.

A Pending Deutsche Bank Moment?

USA TODAY MONEY

WHY WOES AT A GERMAN BANK WORRY WALL STREET

DANIEL ROLAND, AFP/GETTY IMAGES

Whatever happens with Deutsche Bank, global regulators are better equipped to deal with crisis

Adam Shell
@adamshell
USA TODAY

Ever since the fall of Lehman Brothers in 2008 — an event that ushered in the financial crisis — even a whiff of a banking crisis anywhere in the world has resulted in an "uh-oh" moment for Wall Street. And investor reaction was no different last week when reports spread that some hedge funds were paring back risk by moving some cash out of troubled German banking giant Deutsche Bank.

Indeed, the initial Bloomberg report last week of a handful of clients scaling back business with Deutsche Bank led to an initial negative market reaction in the U.S., witnessed by a nearly 200-point drop suffered by the Dow Jones industrial average on Thursday.

In addition to weak profits due to Europe's economic woes, investor concern centered on the expectation that the U.S. Department of Justice would demand a steep $14 billion in penalties for alleged wrongdoing leading up to the 2008 mortgage crisis and comments from German Chancellor Angela Merkel ruling out state aid for the bank.

"It stoked memories of the Lehman collapse," says Terry Sandven, chief equity strategist at U.S. Bank Wealth Management. Back in 2008 a lack of confidence in Lehman's finances caused clients — known as "counterparties" — to ask for their money back, a request a cash-starved Lehman couldn't meet, leading to its eventual bankruptcy filing.

Although fears of another "Lehman moment" still keep investors up at night, the general consensus on Wall Street is that Deutsche Bank's problems, while sizable, won't snowball.

"Whatever happens with Deutsche Bank, this is not — I repeat, not — a Lehman moment," says Don Luskin, chief investment officer at investment firm TrendMacro. "We are not looking at globally interconnected fragility like we were in 2008. And if anything goes wrong at all, after the 2008 experience, the central banks of the world know precisely what to do to put the fire out."

That's likely why the Dow rebounded on Friday and shares of Deutsche Bank that trade on the New York Stock Exchange recovered nearly 14%, trimming its year-to-date loss to a still-sizable 46%.

> **"This is not — I repeat, not — a Lehman moment. We are not looking at globally interconnected fragility like we were in 2008."**
>
> **Don Luskin,** chief investment officer at investment firm TrendMacro

The company has worked to quell fears with messages referring to its financial position as "stable" and pointing to its large number of clients — currently more than 20 million, according to the bank.

While its run-in with the U.S. prosecutors could lead to a big fine, Deutsche Bank has a lot of cash on hand. In a Friday letter to employees, CEO John Cryan said Deutsche Bank has 215 billion euros in cash reserves, adding that it is "an extremely comfortable buffer."

Beyond Deutsche Bank's financial position, global regulators are better equipped to deal with a crisis than they were eight years ago, analysts and money managers say.

"Banking systemic risk is much lower now than in 2007-08," says David Kotok, chief investment officer at Cumberland Advisors. "German bank supervision is also tighter."

The big unknown is what the final fine will be once the Justice Department and Deutsche Bank end their negotiations. Wall Street thinks the ultimate hit will likely be less than the $14 billion the U.S. wants, says Sung Won Sohn, a professor of economics at California State University-Channel Islands. "The potential damage to the bank is overstated," Sohn says.

What's more, given the size of Deutsche Bank, which is Germany's biggest lender and a key pillar of the European financial system, there's little doubt that authorities, such as the European Central Bank or the German government itself, would take the necessary steps to keep the bank operating and avoid a failure.

"When push comes to shove, Merkel will bail out Deutsche Bank," says Luskin of TrendMacro.

Still, Wall Street pros say it makes perfect sense that some clients of Deutsche Bank took steps to protect themselves in the event the German bank's fortunes worsen.

"If you fear a bank has solvency problems, financial managers withdraw from the bank because there is no reward and all risk," says Bruce Bittles, chief investment strategist at Baird. "It doesn't mean that Deutsche Bank is in immediate danger, but you certainly do not want to be the last one out."

The big unknown is what the final fine will be once the Justice Department and Deutsche Bank end their negotiations.

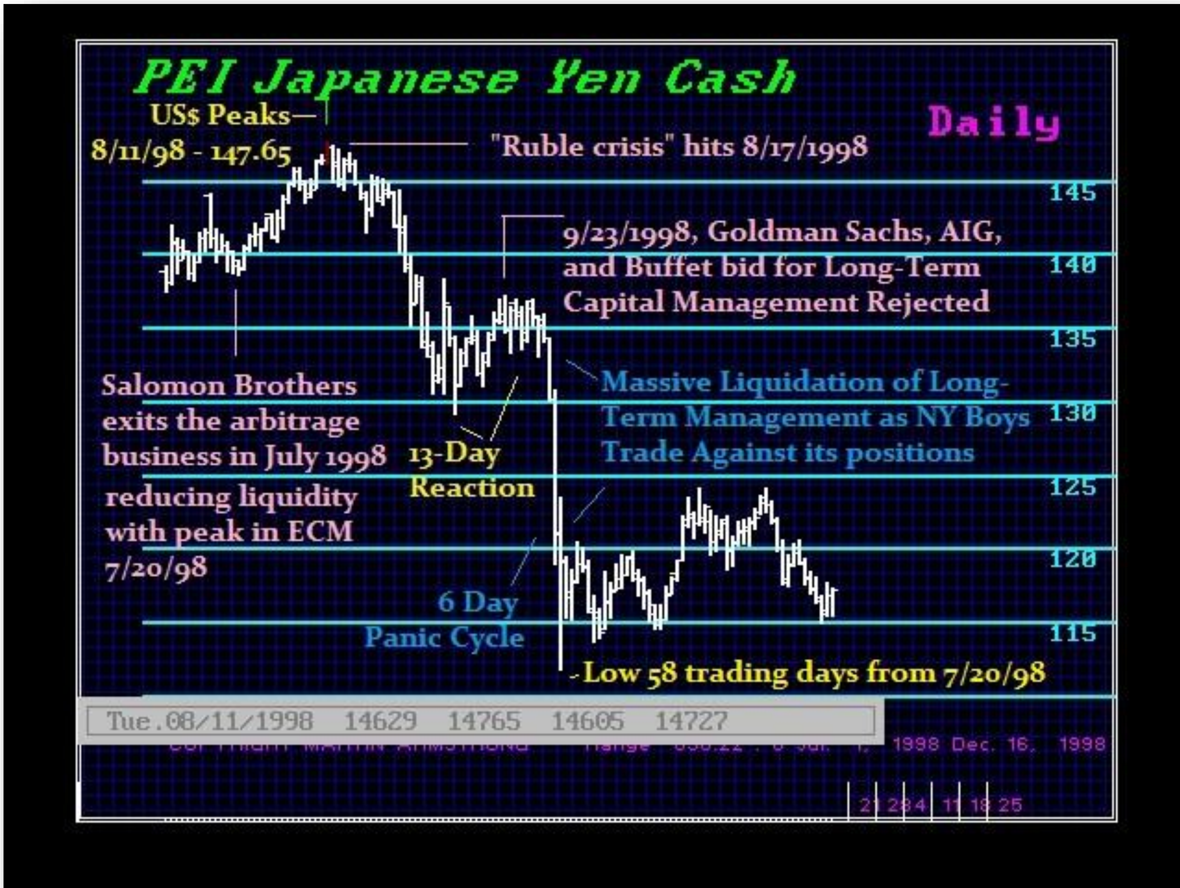
The sales pitch back in 2016 was that this was not a Lehman Moment. They were insisting that this was not a globally interconnected nightmare. Negative interest rates had only begun in 2014, and there was hope that this would revive the banking system in Europe. That never materialized and the insistence that there would be no bailout for Deutsche Bank is only now starting to raise concerns as we approach 2020.

The entire crisis stems from the structural design that refused to consolidate the debts from the outset. Instead, the toxic debt from the 2007–2009 Crisis remained inside the banks and the ECB cut rates to negative in hopes that they would make enough money to cover their losses. That strategy simply has not worked so the crisis from 2007–2009 has yet to be resolved in Europe. Then due to the policy that there can be no bailouts, for that would result in cross-border financing, US banks no longer trust European banks. This is being reflected in the Repo Crisis which is all about counterparty risk.

Over the years, Deutsche Bank was trying to compete with the New York bankers. They dived into the deep end of the pool and created a staggering $53.5 trillion book of derivatives contracts, which are predominantly on interest rates and currencies. They have been systematically trying to reduce those derivatives, which has not been an easy task. Part of its restructuring has been to take its derivatives and other unwanted financial instruments that are now housed in its Capital Release Unit and to sell them off or unwind them over time.

Deutsche Bank reported a $3.5 billion loss for the second quarter, which included its restructuring charges and the layoff of some 18,000 staff of a total workforce of 91,000. Nonetheless, the real problem has been to value their derivative book that they are trying to sell off. The problem with derivatives is that the formulas are never accurate, and this renders them still questionable as was the case with Long-Term Management Crisis in 1998.

Deutsche Bank has marked its derivatives book exposure to about €20 billion ($22.3 billion). In crafting such a valuation, assumptions are injected and these assumptions about future market trends are rarely correct. This is the best guess after netting exposures, assuming losses on one position are offset by gains on the opposite side. This all rests upon the further assumption that the counterparty in a derivative is also good for its commitment. Then there is the risk that clearinghouses will be able to perform and the collateral that has been put up will also be adequate.



If Deutsche Bank fails and the EU/Germany refuses to bailout the bank, the fear is an economic global tsunami that will spread as was the case during the Russian bond crisis of 1998 that resulted in a worldwide liquidity crisis. Assets that had no links to Russia were being sold like the Japanese yen to simply raise cash to cover losses elsewhere. This is why fundamental analysis fails. It is the interconnections that lead to a worldwide liquidity crisis that we are already witnessing first in the inverted yield curve which began on March 25th, 2019, and then the liquidity crisis that manifested in the repo market in September 2019.

While the traditional analysis has proclaimed that a failure of Deutsche Bank is unlikely, the systemic risks tied to Deutsche Bank's derivatives portfolio cannot be qualified and this is why banks no longer trust banks leading to the ongoing Repo Crisis. The negative interest rates by the ECB has not helped banks, and contrary to its intention, negative rates have undermined banks, pensions, and the elderly.

Deutsche Bank
Annual Report 2018

Risk and capital performance
Credit Risk Exposure

The following table shows a breakdown of notional amounts and gross market value of derivative transactions along with a breakdown of notional amounts of OTC derivative assets and liabilities on the basis of clearing channel.

Notional amounts of derivatives on basis of clearing channel and type of derivative

Dec 31, 2018

	Notional amount maturity distribution						
in € m.	Within 1 year	> 1 and ≤ 5 years	After 5 years	Total	Positive market value	Negative market value	Net market value
Interest rate related:							
OTC	12,741,035	9,791,856	5,605,269	28,138,160	202,480	181,453	21,028
Bilateral (Amt)	2,511,405	2,706,991	1,871,607	7,090,004	176,248	156,339	19,909
CCP (Amt)	10,229,630	7,084,865	3,733,661	21,048,156	26,233	25,114	1,119
Exchange-traded	5,643,533	1,813,582	367	7,457,483	560	357	203
Total Interest rate related	18,384,569	11,605,439	5,605,636	35,595,643	203,040	181,809	21,231
Currency related:							
OTC	4,277,488	1,063,548	440,037	5,781,073	85,221	81,555	3,666
Bilateral (Amt)	4,217,941	1,063,386	440,037	5,721,364	84,592	80,765	3,827
CCP (Amt)	59,547	162	0	59,709	629	790	(161)
Exchange-traded	23,137	0	0	23,137	5	7	(2)
Total Currency related	4,300,625	1,063,548	440,037	5,804,211	85,226	81,562	3,664
Equity/index related:							
OTC	265,587	145,152	16,391	427,130	15,645	19,925	(4,280)
Bilateral (Amt)	265,587	145,152	16,391	427,130	15,645	19,925	(4,280)
CCP (Amt)	0	0	0	0	0	0	0
Exchange-traded	605,254	110,450	10,974	726,678	10,407	9,969	438
Total Equity/index related	870,841	255,602	27,365	1,153,808	26,052	29,894	(3,843)
Credit derivatives related							
OTC	115,256	615,668	123,651	854,575	8,197	8,382	(184)
Bilateral (Amt)	71,996	175,015	49,365	296,375	3,138	3,142	(3)
CCP (Amt)	43,260	440,653	74,287	558,200	5,059	5,240	(181)
Exchange-traded	0	0	0	0	0	0	0
Total Credit derivatives related	115,256	615,668	123,651	854,575	8,197	8,382	(184)
Commodity related:							
OTC	5,028	1,015	1,432	7,476	99	1,090	(991)
Bilateral (Amt)	5,028	1,015	1,432	7,476	99	1,090	(991)
CCP (Amt)	0	0	0	0	0	0	0
Exchange-traded	22,727	1,333	0	24,060	246	289	(43)
Total Commodity related	27,755	2,348	1,432	31,535	345	1,379	(1,034)
Other:							
OTC	11,854	2,555	86	14,494	213	337	(124)
Bilateral (Amt)	11,853	2,555	86	14,493	213	336	(124)
CCP (Amt)	1	0	0	1	0	0	0
Exchange-traded	5,244	3	0	5,247	13	46	(33)
Total Other	17,098	2,558	86	19,741	226	383	(157)
Total OTC business	17,416,248	11,619,795	6,186,866	35,222,909	311,855	292,741	19,115
Total bilateral business	7,083,810	4,094,114	2,378,919	13,556,843	279,935	261,597	18,338
Total CCP business	10,332,438	7,525,680	3,807,948	21,666,066	31,921	31,144	777
Total exchange-traded business	6,299,896	1,925,368	11,341	8,236,605	11,231	10,668	563
Total	23,716,144	13,545,163	6,198,208	43,459,514	323,086	303,409	19,678
Positive market values after netting and cash collateral received	0	0	0	0	29,393	0	0

Since Deutsche Bank's derivatives portfolio is predominantly on interest rates and currencies, these are the two primary areas that are under tremendous stress. The Repo Crisis demonstrates the risk in interest rates as the Federal Reserve is desperately trying to maintain control of the short-term rates. A pop in rates will blow up the Deutsche Bank's derivatives book while the less risky equities and credit default swap exposure is a much smaller portion of their portfolio.

Deutsche Bank's 2018 annual report suggests that a mitigating factor remains that much of its derivatives do mature by 2021. But interest rates are already under siege and the dollar keeps rising against the euro. These are the two greatest areas of risk in their portfolio, which can turn very ugly by mid-2020. Their longer-dated interest rate and credit derivatives could be harder to unload as we begin to see signs of another European Sovereign Debt Crisis emerging as we head into 2021.

There has been an exodus of hedge funds withdrawing assets and, sometimes, entire books of business from Deutsche Bank. Much seems to be moved to London despite the claims Brexit will result in banks leaving the UK. That is all political propaganda as the real concerns remain the interconnected banks in the EU.

The estimates have been about $1 billion in assets per day have been withdrawn from the bank since its July 7th, 2019 restructuring announcement, which has played a key role in the liquidity crisis that emerged in September 2019. They hope that this restructuring will cost between €7 and €8 billion.

The change in regulations introduced since the 2008 crisis, which were designed to create more transparency and to raise collateral for funds that use over-the-counter derivatives in contrast to third-party exchanges, are complicating matters for Deutsche Bank selling its derivative portfolio. The final stage of the implementation of these rules was to take place by September 2021.

The MIFID-II (Markets in Financial Instruments Directive) regulations EU financial market directive was to begin in 2018 and was changing everything. Financial analysts employed by banks and securities brokerage firm were likely to find themselves without jobs. MIFID-II was to change research forever by reducing analytical departments on a grand scale. Banks and brokers would be required to show the cost of research and explicitly reimburse their expenses.

The banks and brokerages have not charged for these services until MIFID–II. Instead, they have included their research costs in the fees for executed exchange transactions. This has given customers the impression that the entire wealth of financial analysis they receive is free. This all came to an end very abruptly in 2018.

Total confusion had arisen, leaving the industry unsure how the new rules and regulations surrounding the implementation of MIFID–II were to be imposed. In December 2017, regulators made such a mess of the regulations that they were forced to grant firms a six–month delay. The regulators did not understand what they were regulating, and this left compliance departments totally confused with regards to how to conduct business in the future.

The most critical problem surrounding this nightmare is the fact that every trade (with a European counterpart) will require an LEI (Legal Entity Identifier). This is not such a critical issue for Wall Street Banks since they have already won a 30–month grace period after the SEC requested time to negotiate terms with the EU. Goldman Sachs installed another one of its board members as the top negotiator inside the SEC – Alan Cohen.

Not all EU countries have come to terms with LEI. During the six–month grace period of relief, any investment firms may trade with clients under the condition that before providing services, the firm must obtain the necessary documentation to at least apply for an LEI code on its behalf.

MIFID–II rules went into force as of January 2018, and have been subjected to widespread criticism of the legislation. The overregulation seems to be more intent on tracking what clients do rather than protecting clients. Issues that have come into question are changes to the cost and distribution of market data, investor protection rules, and research for small companies. MIFID–II legislation is very complex with more than 1.7 million paragraphs of documentation, which took seven years to be implemented. This has hurt business and the European directive has resulted in complete confusion in a number of areas.

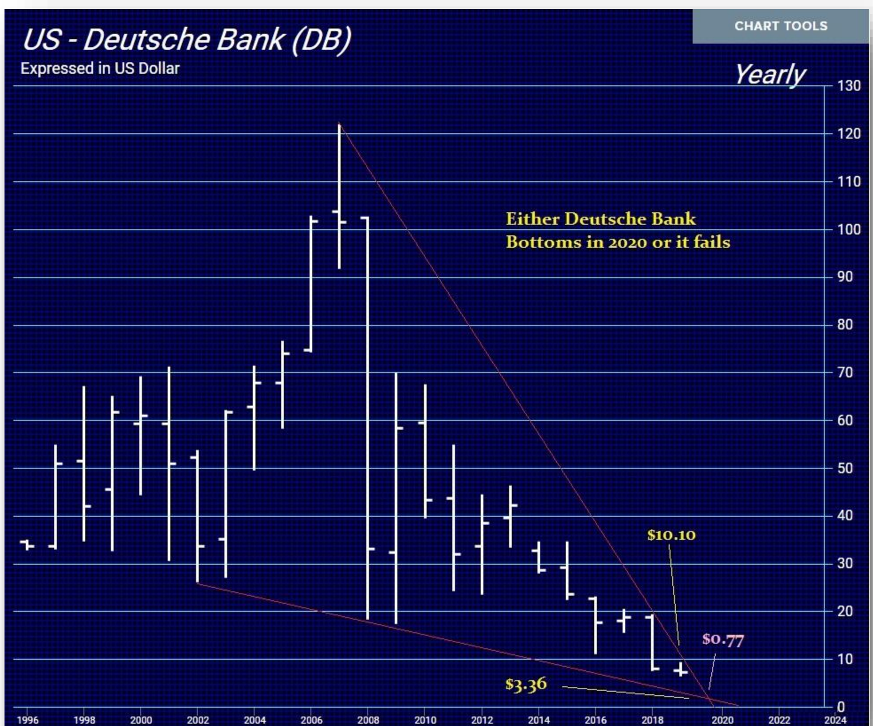
The Financial Conduct Authority (FCA) also stated that it would launch a sector-wide review of post-MIFID-II research prices in September 2019. The UK regulator warned that cross-subsidies and deliberate undercharging may be undermining competition. In March 2019, the FCA fined Goldman Sachs £34.3 million for 220 million transaction reporting failures under MIFID rules. This followed UBS being fined £27.6 million for similar failings. This has only added to the problem of the growing liquidity crisis.

Another complicating factor has been the Libor rate, or London interbank offered rate, which has been used as a benchmark for pricing interest rate pegged contracts. The charges of manipulation filed against the banks have resulted in this key interest rate, like repo, being phased out. This has further made valuations of existing derivatives contracts very difficult. The Libor rate is scheduled to be phased out at the end of 2021. Despite this major development that's occurring in just over two years, Libor rates still serve as benchmarks for trillions of dollars in securities across the globe. An estimated $200 trillion in financial contracts and securities, which includes derivatives, continue to rely on Libor although this is down from $350 trillion in 2017.

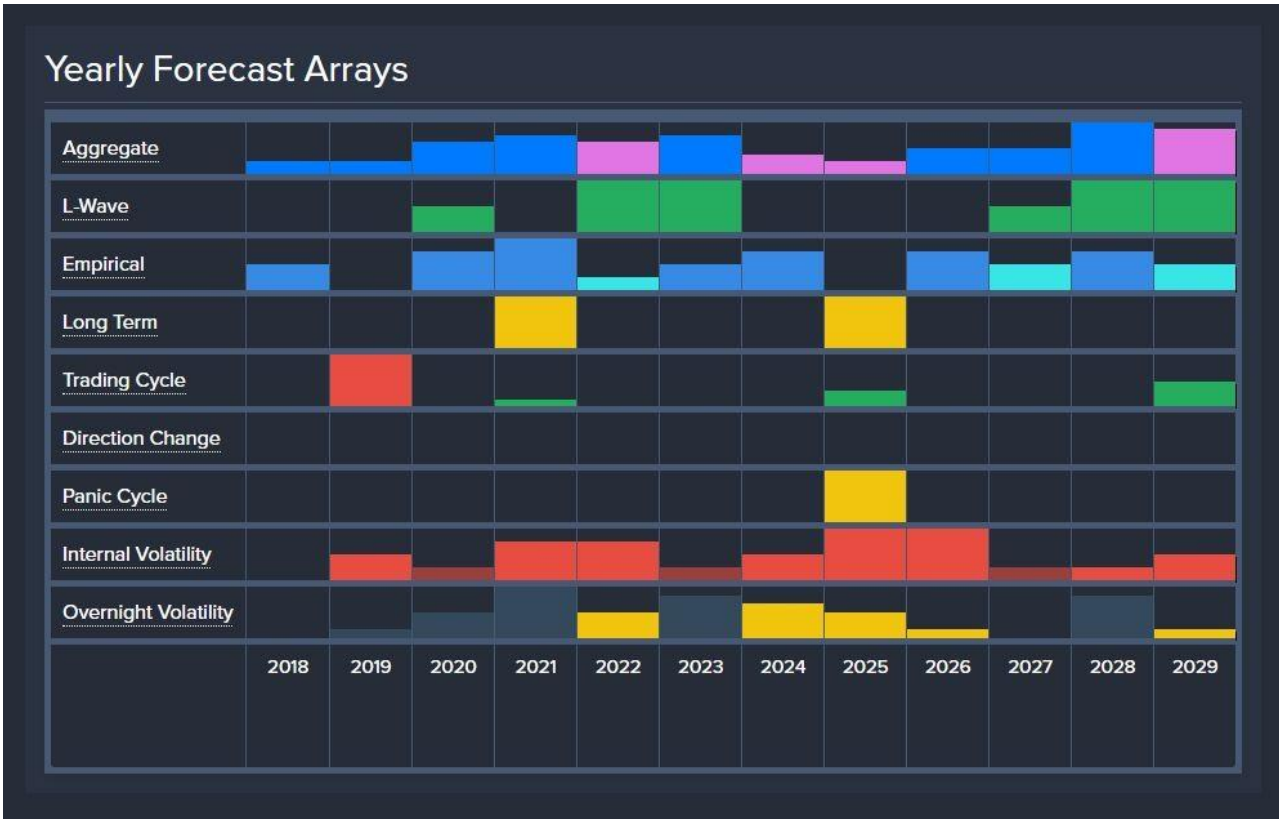
The manipulations of Libor are truly just running stops, not actually manipulating the trend or changing a bear market to a bull market. That is what central banks do. The charges of manipulations to the point of terminating Libor are exaggerated. Nevertheless, both the U.K. and U.S. regulators have warned market participants recently not to add to the Libor "hole," but to start adopting the alternative benchmarks already in use.

This is the worst possible time for Deutsche Bank to sell its derivatives book given such a state of confusion over MIFID-II and the shutting down of Libor, which is really competition to central bank manipulations. Obviously, there are higher margin fees to be attached, and that could potentially inhibit that sale of particularly fixed-income derivatives products.

The absence of an active underlying Libor market raises a serious question about the sustainability of the Libor benchmarks in the future or pricing the Deutsche Bank derivative book. If an active market does not exist, how can even the best run a benchmark measure it? The impact of this decision from the FCA is to put uncertainty into all Libor-based swap rates which undermines Deutsche Bank's portfolio.



The combination of these factors has left Europe's biggest bank, Deutsche Bank, in crisis mode and its stock has declined for 12 years reflecting the real problems that have never been resolved. Historically, when a stock falls as far as this decline of Deutsche Bank, the entity does not survive. Technically, the downtrend line moves below the uptrend line, which has actually been pointing down because the stock has been so bearish. It looks like we reach the do or die moment perhaps in early 2020.



From a timing perspective, there is a gap on the Empirical levels of our timing models, which tend to imply a turning point. It is the opposite of the highest bar. It may be that 2019 presents the lowest yearly closing and the new head of the ECB, Christine Lagarde, appears to be hell-bent on forcing Germany to step up to the plate despite the no bailout policy.

Eurozone governments, particularly those with budget surpluses, have long been under pressure to spend more and thus boost the 19-member region. Christine Lagarde knows that the ECB cannot do anything to save Europe and is lobbying for fiscal stimulus. Lagarde's call for a new policy mix in Europe is paramount.

She warned that there were ongoing trade tensions and geopolitical uncertainties that have contributed to the economic slowdown. These are only recent factors that she can point to, but the economic decline has been in full swing since 2007.

It is clearly more than just world trade growth, which declined by more than 50% in the past year. Consumers will not buy when the future is uncertain. We see the rise in political uncertainty everywhere from Trump impeachment proceedings, Brexit, Hong Kong protests, South American turmoil, India and Pakistan, and starvation in North Korea. You cannot expect trade to expand when consumers are pulling back. Global trade growth has declined as China shifts to a more domestic economic model and Germany clings to its mercantile model dependent upon exports. This has resulted in global trade growth declining to its lowest level since the great financial crisis of 2007–2009. The shift in China has been part of a major structural change in nature for the world economy.

Clearly, the ECB has eased monetary policy to the point of all-time low negative deposit rates and has effectively devalued money to its lowest point in 5,000 years. Nevertheless, Christine Lagarde points to Germany and the Netherlands who both have surpluses. Lagarde argues they also have adequate fiscal space to boost spending, but are reluctant to increase their debt levels. She argues that they must move to deficits to save all of Europe. Our models indicate that not even that will save Europe. They need tax reductions, not tax increases to support government spending that never provides any direct economic stimulus.

Our capital flow models are indicating that there is a high concentration of dollar hoarding taking place in Germany as fears continue to exist over the future for Deutsche Bank. The intense fears over Deutsche Bank are centered on its derivative book in light of all the complications. The true danger is that there are cross-positions entangled throughout the banking community, which stretch even into the United States.

The performance of Deutsche Bank shares reflects the crisis in European banking and why Europe has been unable to recover 22 years later. It is their derivative book which has tentacles that stretch with deep links into the major US banks that are highly involved in derivatives.

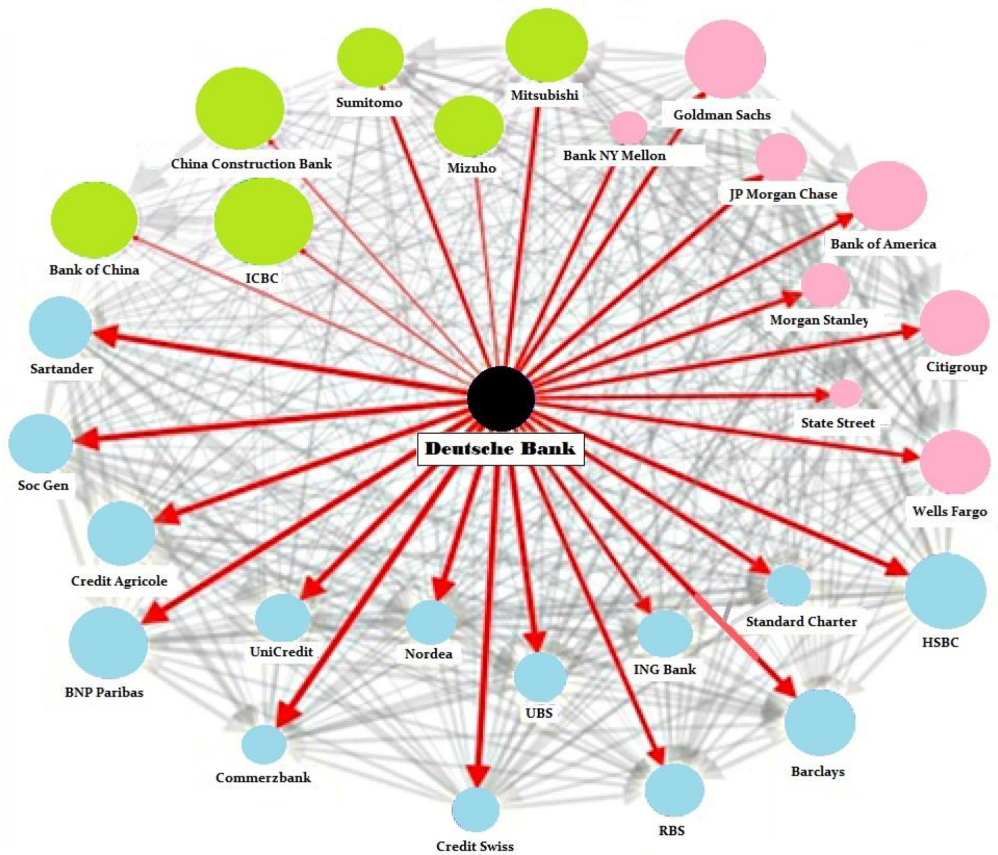
The primary concern has been that Germany and the EU policy not to bailout banks will result in a major contagion globally. This time, a European banking crisis can impact the US banks which the Fed cannot control, as was the case back in 2007–2009 when the origin was the USA. The Fed went as far as to bailout American Insurance Group (AIG) for if it went down, it would have taken Goldman Sachs with it. They let Lehman and Bear Sterns fold because they were competitors of Goldman. The dilemma this time is the Fed cannot bailout Deutsche Bank.

The crisis in liquidity is emerging as players fear a host of scenarios, but remember the Lehman Brothers and Bear Stern crisis took place in the repo market first. For that reason alone, many banks/corporations are hoarding dollar instruments but are reluctant to put them in the repo market for fear of default at any moment with no predictability of who has exposure to what. This rising fear of counterparty risk has led to many preferring to just park funds in the USA, but they appear to prefer T-Bills. Looking at the Federal Reserve Excess Reserve facility, it stood at $2.1 trillion the week before the Repo Crisis and dropped sharply to $1.8 trillion by September 27, 2019.

The bank stocks being hit are all those with high derivative exposure linked back to Deutsche Bank. That means the leader in this banking risk decline is, of course, Goldman Sachs. The others in order of risk are Citigroup, Morgan Stanley, Bank of America, and JPMorgan Chase. The bank with the least exposure in the USA to derivatives is Wells Fargo.

Changes the Counterparties

The big boys who play the repo market have understood the game and how it changed post-2007-2009. They set up shell branches in different jurisdictions using the name of the bank. Therefore, you may think you are dealing with a major name, but the actual entity you are dealing with is a shell company set up where its capital might be just $1,000. This game playing has also contributed to the unraveling of globalization in the financial markets because it has raised deep concerns about who you are really dealing with in addition to raising the problem of counterparty risk.

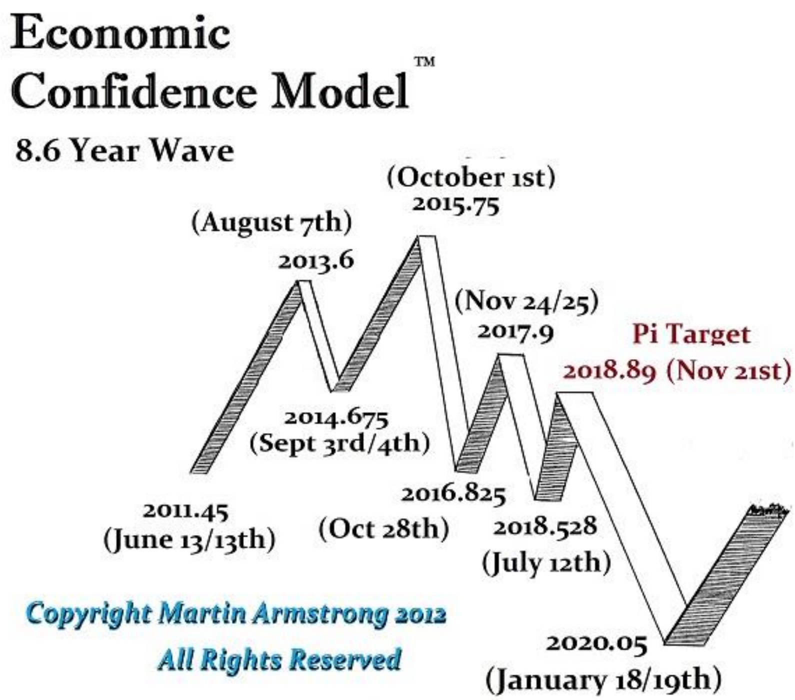


Deutsche Bank Interconnections

Our forecast for a liquidity crisis starting after Labor Day was spot on. Thus far, the Federal Reserve has had to funnel billions of dollars every day into the repo market, providing an emergency source of liquidity to prevent another meltdown with short-term rates rising — the one thing the Fed is supposed to be able to control. Notably, Deutsche Bank is heavily interconnected to the behemoths of Wall Street through derivatives.

The U.S. banks that were named as being heavily interconnected to Deutsche Bank via derivatives in a 2016 report from the International Monetary Fund (IMF) were: Goldman Sachs, Citigroup, Morgan Stanley, Bank of America, and JPMorgan Chase. Among the insurers with exposure to Wall Street's derivatives mess, Lincoln National has been at the top of the list.

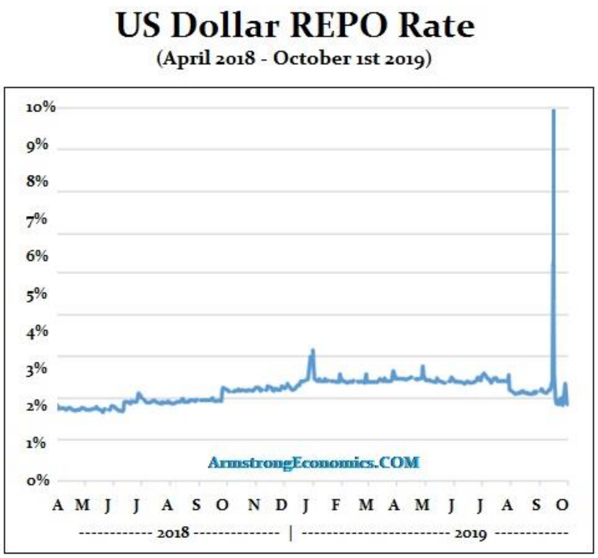
It is also quite notable that Wells Fargo, which is the third-largest bank in the U.S. by deposits, has fared far better than its peer banks. This further suggests that the sell-off was all about derivatives and shaky counterparties since Wells Fargo has the smallest exposure to derivatives among the largest Wall Street banks, according to data from the Office of the Comptroller of the Currency.



There is further proof that something is amiss with the largest banks on Wall Street. When the Fed offered its 14-day repo loans, there was twice as much demand as money offered by the Fed. The banks bid for $62 billion while the Fed was offering only $30 billion. This is further indicating that there is a shortage of dollars as hoarding is beginning to increase dramatically.

This time, the economic pressure will continue into the turning point on the Economic Confidence Model (ECM) going into January 18/19, 2020.

The Federal Reserve announced that its repo loan program, which began on September 17th, 2019 after repo rates jumped to 10% on September 15th, would be extended into October. The Fed's open market operations have calmed the short-term funding market, but the central bank remains under pressure to find a solution to the cash crunch that sent rates spiking recently.

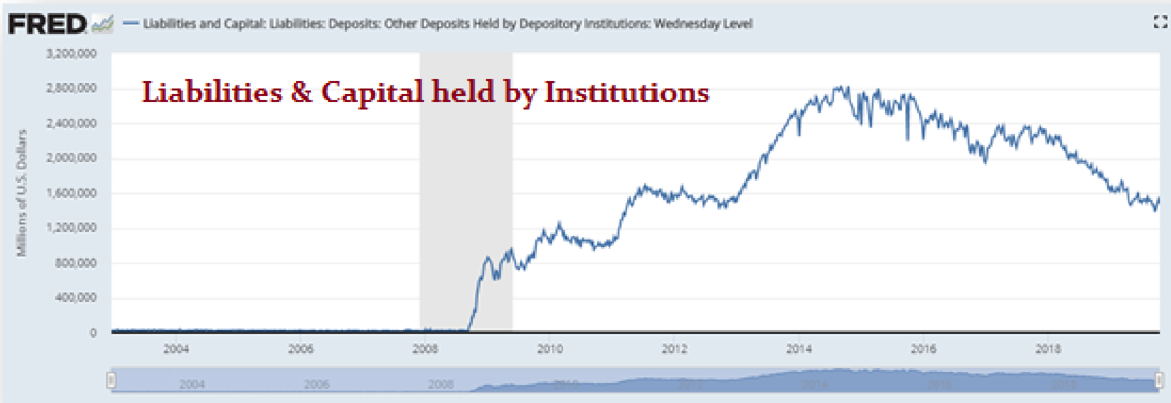


In a repo, one party sells a security (such as a Treasury security) and then repurchases it at a higher price on a pre-specified date. Repos are an important source of short-term liquidity for financial institutions, including hedge funds, and are economically equivalent to collateralized loans. The 2007-2009 crisis took place because the credit rating agencies were bribed to rate mortgage-backed securities as AAA, thereby qualifying them to be placed in the repo market. When the loans could not be repurchased, suddenly this is what brought down Lehman Brothers and Bear Sterns in the blink of an eye. This is why the first sign of panic has taken place in the repo market for that is where it all began in February 2007.

FFR v REPO

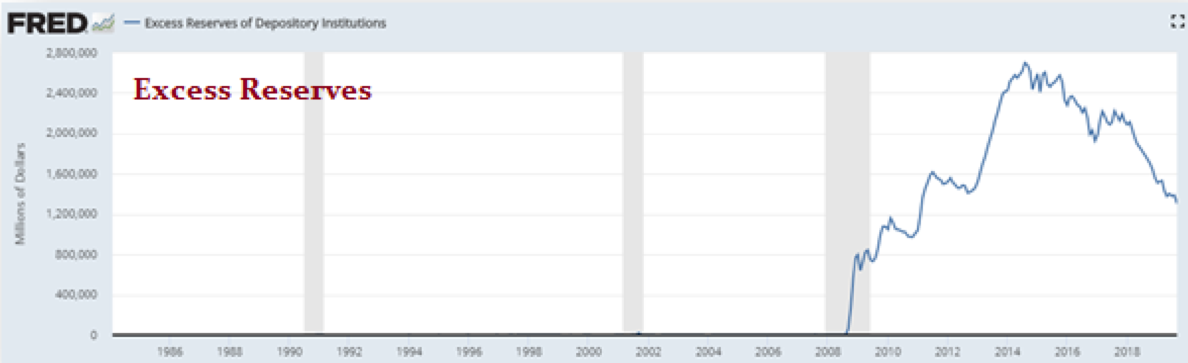
For depository institutions (such as banks), another important source of short-term liquidity is the federal funds market, where they borrow and lend each other bank reserves. The interest rate in this market, the Federal Funds Rate (FFR), is the Fed's primary target for monetary policy. Because these private markets are similar, their rates are typically very close.

Although individual banks choose how much they will hold in reserves, the Fed, counterintuitively, controls the overall level of bank reserves. Before the 2007-2009 financial crisis, the Fed kept the level of bank reserves relatively low and targeted the FFR through open market operations primarily through repos. When it wanted to increase reserves and put downward pressure on the FFR, the Fed lent cash in the repo market. When it wanted to do the opposite, it borrowed cash in the repo market. Since the demand for reserves shifts frequently, the Fed continually adjusted its repo activity to keep the FFR stable.



The Fed's method of targeting the FFR changed significantly following the financial crisis 2007–2009. Given the Fed's crisis response programs, such as Quantitative Easing, the Fed expanded the level of bank reserves from less than $50 billion to as high as $2.7 trillion. The Fed suddenly realized that it could no longer target the FFR using repos because reserves were so abundant that there was little need to borrow them. Consequently, the market clearing interest rate fell to zero.

Instead, the Fed began paying banks interest on reserves to target the FFR. This became the Excess Reserve facility which defeated the entire theory of Quantitative Easing. Banks simply deposited excess capital at the Fed rather than lend it out to stimulate the economy.



In 2014, the European Central Bank (ECB) took its interest rates to negative. The large European banks with US branches began to send capital to their US offices which were regulated by the Federal Reserve. Their US branches then posted their excess reserves with the Federal Reserve and earned interest. This only aided the decline in the euro against the dollar as it crashed from its major high in 2008.

In 2014, the Fed began to "normalize" monetary policy, including gradually reducing bank reserves from over $2.5 trillion to around $1.5 trillion. Instead of returning to the pre-crisis model of scarce reserves, the Fed adopted a new strategy aiming to keep reserves just abundant enough that repos would not be needed to target the FFR. Because of this strategy and the fundamental changes in market conditions with the clash of the ECB going negative, it became a question of exactly what level of reserves would meet the "just enough" theory. Events in September 2019 thrust this strategy to the surface, creating highly unusual circumstances that were being impacted by fear of a Deutsch Bank contagion. Suddenly, the current level of reserves was not high enough to preclude the need for open market operations.

What Caused the Recent Repo Spike?

There is no indication that the recent spike in repo rates was caused by a domestic panic based upon economic conditions. Instead, this sudden panic in the repo market was caused by what appeared to be a temporary increase in the demand for cash and a decrease in the supply of bank reserves. But that was clearly not caused by a domestic change in economic conditions. Moreover, someone was chasing dollars desperately and thus willing to pay 10%.

Some tried to argue that federal tax payments were due on September 15, which had something to do with the panic. When taxes are paid, money is initially transferred out of the reserve account of the taxpayer's bank into the Treasury's account at the Fed. That seemed to make some logical sense, but that would justify a single day and not a prolonged crisis.

Then the second explanation put forth was that a relatively large Treasury debt issuance at that time similarly transferred money out of the reserve account of banks (who purchased the securities for themselves or customers) and into the Treasury's account. Again, that might account for a single day but not a prolonged shortage of cash in the repo market.

Then there was the excuse that financial reporting requirements at the end of the third quarter had made banks temporarily less willing to lend in the repo market. That really made no sense whatsoever and was up there with the excuse, "I did my homework, but the dog ate it."

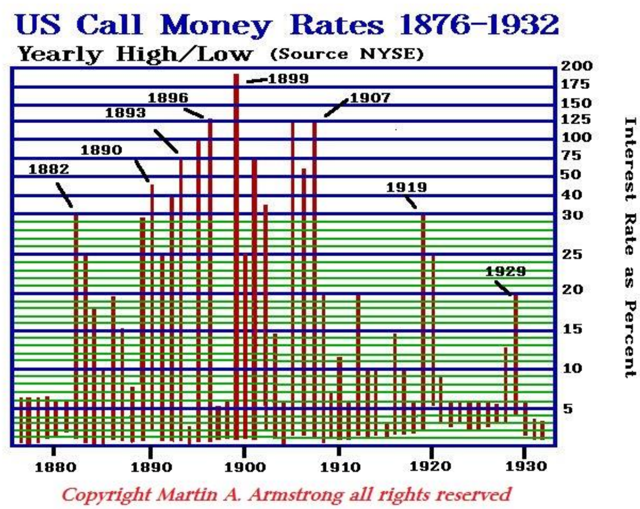
Obviously, there was something else brewing behind the curtain in order for the crisis in the repo market to extend beyond a single day. It was even more than merely the changes in Fed policy pre-crisis and post-crisis.

These events certainly highlight several issues stemming from post-crisis monetary policy and financial regulatory changes. But they also exposed that we have a crisis on a contagion basis which necessitates us to look beyond the domestic borders.

Shortage in Dollars

During a liquidity crisis, which we have begun post-Labor Day, the shortage of dollars forces real rates to rise and that can be very dramatic. Don't forget that it was the repo market that brought down Lehman Brothers and Bear Stearns. This is why we now have counterparty risk concerns and they are forcing the Fed to come in and provide the cash. This is how the free market prevails. The Fed was poised to lower rates when the repo crisis began. With rates soaring to 10%, this negated the Fed's ability to lower its federal funds rate.

Liquidity Crises 1899 & 1998



In 1899, there was a major liquidity crisis when call money rates soared touching 200%. The Federal Reserve did not exist at that time, but the Bank of England (BoE) did. There was a surge in British stocks and the BoE feared speculation. Their discount (wholesale) interest rate was set at 3% in February 1899. They intervened and doubled the interest rate to 6% in November 1899. This set off a major financial panic. The British investors in America were forced to sell assets to take money home to meet the liquidity crisis created by the BoE. This was similar to the 1998 Liquidity Crisis sparked by the Russian Bond Crisis. This 1899 Liquidity Crisis created a global contagion and the US market plunged into a massive liquidity crisis which was externally created by the BoE (International v Domestic policy objectives).

The USA had no central bank, so the call money rates were a totally free market. The week of December 4, 1899, saw the US share market collapse after opening below the previous week's low and plunging 20% in just two weeks. On December 18, 1899, the call money rate touched 200% in the midst of this liquidity crisis, which is what we face here again going into 2020.

The Fed's Options

The Fed has three options to ensure Federal Funds Rate (FFR) stability under its monetary policy theory:

1. It can continue interventions into the repo market (like the recent ones) as needed

2. It can purchase assets to increase bank reserves to the point where the supply of reserves always exceeds demand and repos are unnecessary, in theory, if the crisis is purely domestic (not likely)

3. It can create a standing repo facility where financial firms can borrow cash on demand, setting a rate on the facility that would put a ceiling on repo rates. After all, the Fed has previously created a similar facility that created a floor on repo rates known as the Overnight Reverse Repurchase Agreement Facility, whereby financial firms can lend the Fed cash on demand

Clearly, such ad hoc interventions were widely accepted as the standard way to conduct monetary policy prior the 2007–2009 crisis. Monetary policy, by nature, involves some form of market intervention. A drawback to this approach is greater confusion and increased market volatility in interest rates.

Fed's Dilemma Domestic v International

The Federal Reserve is facing urgent calls to find a permanent fix to the short-term funding crisis in the repo market that has unsettled markets as a whole. The Fed is concerned about volatility at the end of the year when the demand for cash is expected to rise again seasonally. But the contagion from Europe over concerns with respect to their banking crisis remain off the headlines of the mainstream media for fear that such news could spark another major crisis.

Traders were absolutely stunned by the September 2019 panic in the repo market. Many were far too new to the game given the last crisis was 10 years ago. This is an exclusive market for repurchase agreements where banks and hedge funds borrow money in exchange for Treasuries and other high-quality collateral that is not available for trading to the average player. The repo rate jumped as high as 10%, prompting accusations that the Fed had lost control of short-term interest rates, but there was tremendous confusion as to why a panic even unfolded because of pretend analysts with no experience in this institutional field.

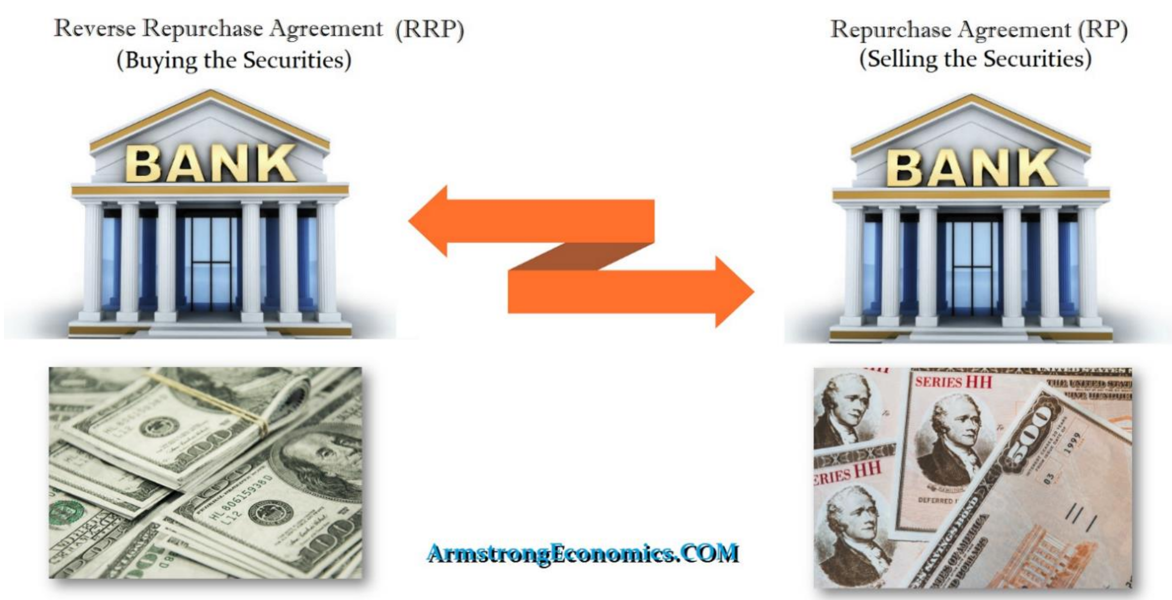
The panic forced the Fed to inject cash in order to bring the rate back down. Clearly, the Fed has lost control of even the short-term market rates, which have been in their exclusive control, and created confusion as to what is really going on. Many are now wondering what is taking place and have been pushing for a longer-term answer to this sudden crisis that is now impacting confidence.

Market participants have appeared to reach an answer they are pushing upon the Fed — more asset purchases under Quantitative Easing to increase the cash in the system. When the Fed buys Treasuries from the market, it simultaneously credits banks' reserve accounts to pay for them, increasing the amount of cash in the financial system. However, this is purely a domestic myopic view of the economy that excludes influences from external markets.

With the ECB at negative rates and the US at positive, then with the continued bearishness over European banking and the refusal of the EU to bailout banks, the central bank cannot hope to manage the economy when it cannot intervene into external markets.

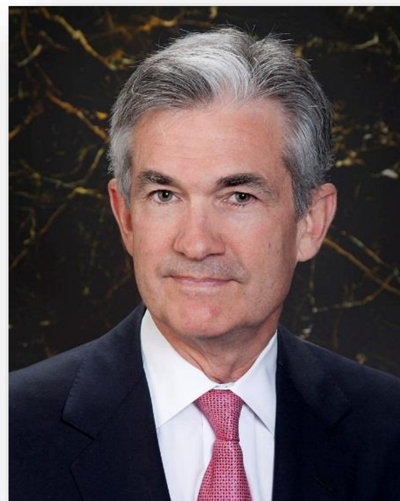
Reverse Repo

Without question, something fundamental needs to be done. However, this crisis is stemming from Europe and cannot be controlled by the Fed. The ECB is locked into permanent Quantitative Easing, which has utterly failed. The worst of the market stress began with a series of daily $75bn cash injections. But this quickly morphed into $100bn overnight operations and three two-week loans. The crisis was not easing but expanding, which rules out the excuses that it was a one-time event due to tax payments and other nonsense. The demands for daily funding initially outpaced what was on offer from the Federal Reserve Bank of New York. The ad hoc intervention reached a sheer scale with roughly $200bn of cash on loan for the final day of September 2019.



Therefore, instead of taking cash out of the system, the Fed was compelled to inject cash doing a Reverse Repo. A Reverse Repo (RRP) injects the purchase of securities with the agreement to sell them at a higher price at a specific future date. The party selling the security to raise cash in the market agrees to repurchase the securities (repo) from the lender at a future point in time which is known as a Repurchase Agreement (RP). Repos are classified as a money-market instrument, and they are usually used to raise short-term capital.

Consequently, this was the first direct injection of cash to the banking sector since the 2007–2009 financial crisis. In the week of September 16, 2019, there was a shortage of cash in the repo market that was caused by the demand for dollars in Europe and the refusal of domestic US banks willing to lend to Europe. That crisis drove overnight repo rates to 10% from about 2% the week before. Even more disquieting was the way volatility in the repo market pushed the effective federal funds rate to 2.30%, above the 2.25% upper limit of the Fed's target range. This disrupted the intended action of the Fed which was preparing to drop that ceiling to 2%. Suddenly, the shortage of dollar and dollar hoarding disrupted domestic policy objectives.



Fed Chairman Jay Powell had to concede that the central bank will "over time provide a sufficient supply of reserves so that frequent operations are not required" in keeping with the "ample reserves" policy it adopted in January 2019. He did not offer any further explanation on what a sufficient supply would even be under the Fed's view.

This was simply because the Fed did not understand the cause was external. They have now begun to realize that this crisis is emerging from a dollar shortage and hoarding sparked by fears emanating from Europe. We are witnessing the unraveling of globalization and counterparty risk plagued by uncertainty. At the ECB, Christine Lagarde is starting to comprehend the crisis and that the EU cannot simply refuse to bailout Deutsche Bank without disrupting the entire world.

EUROPEAN CENTRAL BANK

EUROSYSTEM

Nobody wants to lend capital out and have what could become known as a "Deutsch Bank moment." The policies of the ECB are so counter trend to that of the Fed that an international crisis is being forced upon the Fed and unfolding as a major international contagion. To make matters worse, the artificially low interest rates have led to derivative plays being sold to pension funds, further complicating the prospect of a major dollar crisis that is starting to unfold.

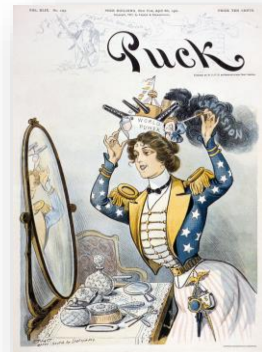
Can the ECB Collapse?

The European Central Bank (ECB) has become the most vulnerable central bank perhaps in history. The fear of the Sovereign Debt Crisis of 2010–2012 where there was a concern that the euro would fail remains alive and intact. The failure to have consolidated the debts of member states has left the EU vulnerable to a breakup for it has infected everything right down to directing only bail-ins since a bailout would mean cross-border funds to bail out banks in other countries.

There is a confrontation brewing between the new head of the ECB Christine Legarde and the political powers primarily in Germany. This confrontation is over austerity in the form of maintaining surpluses and refusing to "stimulate" the economy in a Keynesian fashion. Legarde is insisting upon fiscal stimulation, realizing that there is little that the ECB can do with interest rates already negative. Legarde is in favor of eliminating cash and forcing Europeans into electronic money that she sees would help to boost the balance sheet of banks. This may come into play in her hard battle against Germany and its austerity philosophy that is at odds with the rest of the world.

Nevertheless, there is a serious risk that this standoff between the ECB and the fiscal political side will carry on to the point that the public witnesses firsthand that the ECB could actually collapse. Of course, that will be the critical moment where the very existence of the euro will hang in the balance. Either the fiscal political side blinks or the entire euro system can completely fall apart. The way politics tend to work, they are unlikely to act until they actually see they will lose everything.

Rising Populist Movements, Threats, & Intimidation



Today, Eurocrats in Brussels live in denial of the rising populist revolution that has been sweeping the continent under the pretense of losing their identity to Islam and as a result of declining economic conditions. They responded aggressively with the veiled threat of economic Armageddon in a bid to dissuade further dissension amongst member states. The ECB even declared that any country leaving the euro will face huge financial consequences. The response to the rising separatist movements has been threats and intimidation.

Writing a letter to two Italian MPs, Draghi bluntly declared: "If a country were to leave the Eurosystem, its national central bank's claims on or liabilities to the ECB would need to be settled in full." In other words, all the bonds the ECB bought through its misguided Quantitative Easing policy, he claimed, would have to be paid in full. A very nice Armageddon style threat, but can it be enforced?

In Italy there were proposals to simply default on the bonds held by the ECB. Italy's liabilities to the ECB stand at about €358bn. Even if Italian voters chose in a democratic referendum to leave the single currency and return to the Italian lira, it is unclear how the country's government could raise enough cash to pay off such a mammoth bill in one go. Under what authority could the ECB enforce such a decree? Short of hiring an army to invade Italy, as in the good old days of the barbarians sacking Rome, conquest economics of Napoleon or Hitler, or gunboat diplomacy, quite frankly Italy could just default and let the chips fall where they may. What would Draghi do then? Scream? The more likely result will be to simply push member states to the point that they just default on the ECB.

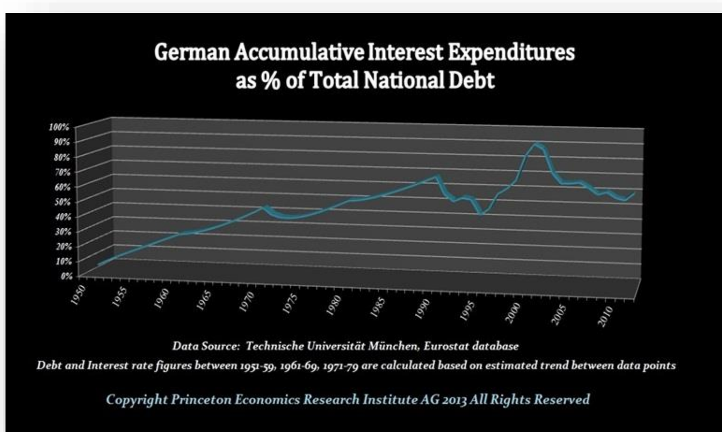
France's deficit is at least a bit more manageable €38bn while Greece's is €30.5bn. Italy is in the worst shape. Nevertheless, being forced to raise that much at one go would result in Draconian taxation and confiscation of assets to the point that such oppression would lead to war. Previously, Italy just seized 10% of all cash in bank accounts to pay their debt, which is a proposal the IMF is actually making.

How quickly people forget, but that is exactly what the other European states did to the German people after World War I, oppressing the people to pay reparations. Those punitive actions against the German people opened the door for the rise of Hitler. The EU project that was intended to create European peace could easily become the very cause of the next European Civil War.

Without the ability to control fiscal policy, spending, and taxation, the ECB really cannot control the economy singlehandedly. Buying bonds and attempting to simply inject capital into the system has had no effect and could not because it is hamstrung by the structural flaws from inception. No amount of capital injection would ever reach the average European consumer across all the borders for it is simply indirect.

The entire policy of Quantitative Easing has been more like a medieval doctor who bleeds his patient and assumes when the patient dies that it was not the method of bleeding or blood loss, but the fact the doctor did not bleed the patient soon enough.

Government debt is unsecured and always defaults throughout history. Buying in government debt and handing banks cash is indirect and they will still not lend the money out for fear of further losses. This will never stimulate the economy or help companies avoid layoffs. This is only a life support system purely for banks and governments. Indeed, the constant buying of government debt has discouraged any economic reform. The entire idea of the Maastricht Treaty to limit debt is absurd. It acknowledges they will continually borrow without end provided new borrowing remains within a low percentage of GDP. It fails to address the endless growth in debt and interest expenditure.



The percentage of interest expenditures to keep the debt rolling has been dramatic. With $15 trillion in negative-yielding debt that only punters want, they hope to reduce this factor of accumulative interest expenditures. However, at negative rates, the only buyers will be the ECB so they might as well stop borrowing and just print money.

Surely from a purely economic standpoint, government debt is always the greatest risk. Yet, the marketplace pretends it is "riskless" (AAA) merely because of sheer power and the state can create money to repay. Venezuela has not defaulted on its pensions, but what they pay will not buy a cup of coffee.

When the government is the biggest issuer of debt, everything changes. Rome failed, not because it was unable to borrow money when it had no national debt, but once confidence in government collapsed. The Roman people began hoarding even the debased money, shrinking the velocity of money, and compelling government to debase the money supply to make ends meet on a continual basis.

Hoard of 52,000 Roman Coins
3rd Century AD discovered in Britain 2008

The Quantitative Easing of today has had zero direct impact on the economy, for the money injected cannot be directed or targeted to the domestic economy when it is government bonds rather than corporate paper bypassing the banks. Buying in government bonds has no guarantee that the money will even remain within the domestic economy since holders can be overseas, no less reach the people to help them with buying groceries.

The entire theory is poorly constructed and never investigated. The IMF told Germany it should raise its property tax, cut social welfare contributions, and invest more to reduce income inequality — a full-blown Marxist agenda. The IMF has demanded higher taxes on savings deposits in Germany, stating it must do more to raise taxes to impose a socialistic agenda by taxing the rich to create broader participation of all citizens in the fruits of economic growth. The IMF has warned that there is a relatively high tax burden on lower incomes with a comparatively low burden on assets.

The IMF's argument is that higher taxes on property is in fact necessary and that the government should demand higher wages to give impetus to the growth in Germany. Yet, this is magically creating no inflationary impact. Years ago, Italy simply imposed a tax on money in one's account. This was called a "capital levy."

This was a one-time charge as an exceptional measure to restore the sustainability of the debt.

The IMF is also suggesting that measure be invoked to help the coming Sovereign Debt Crisis. The attractiveness of such a measure is that a one-time tax can be levied before a tax evasion can even occur, especially if cash is eliminated and money can only exist in bank accounts. This requires the belief that this measure is unique and never repeated.

The IMF has already calculated how much the measure would cost every Eurozone citizen:

> "The amount of the tax would have to bring the European sovereign debt back to the pre-crisis level. In order to reduce the debt to the level of 2007 (for example in the euro area countries), a tax of about 10 percent is needed for households with a positive asset. "

As you can see, there is never any discussion about reducing taxes or the size of government. The solution is always to raise taxes and to not even look at the old Italian trick of a 10% seizure of all cash in your account. We highly recommend diversifying to assets that are movable and not subject to taxation merely to possess.

Add to the capital levy the bail-ins, increased taxation, and austerity, and even stirring this potion gently will produce explosive results. European economic growth remains extremely weak and inflation has failed to pick up as much as the ECB had anticipated because, on the fiscal side, governments are not lowering taxes and that is the only way to reignite demand inflation from the consumer.

Increasing taxes and tax enforcement has only squeezed investment, reduced job growth, and stifled economic growth while negative interest rates have undermined the elderly and pension funds. Increasing the money supply that never reaches the pockets of the consumer is pointless, especially when banks are not interested in lending in the face of seriously underperforming loans as taxes and tax enforcement increase.

There is absolutely no credibility in terms of "stimulating" the economy when whatever loose policy the ECB has attempted was offset by the oppressive fiscal side.

The ECB became the first major central bank to follow Larry Summer's recommendation to move to negative interest rates, which was yet another tax on money. The ECB cut its deposit rate below zero in 2014, punishing

people for saving money when in fact they feared the future. People will not spend lavishly when they are uncertain about what the future will bring.

Clearly, the ECB cannot stimulate the European economy with QE unless it also lowers taxation, which it does not control, and buys only private debt directly to stimulate the economy instead of subsidizing governments. Germany's demand for austerity has further complicated the entire mess and the oppressive fiscal policy is only undermining the European economy as a whole.

The reality remains that the ECB is a completely different animal from the Federal Reserve, Bank of England, or even the Bank of Japan. Pushing member states to the point that they must crush their own domestic economies puts at risk a further breakup of the Eurozone.

As Italy was pondering, they should just default on their debt held by the ECB. Once one-member state is compelled to do so, we have a serious risk that the ECB can indeed go bankrupt unlike that of any other central banks, for it lacks control over Europe as a whole.

The crisis will build until the political side realizes that they can lose the entire euro project. There must be a compromise between the political fiscal side that stops raising taxes, accepts that they must do bailouts rather than bail-ins, and they must stop this austerity philosophy. Failure to adopt these measures threatens, not just the existence of the ECB, but the survivability of the euro itself. The question becomes – will Germany surrender austerity?

The Repo Market Is Broken

The Federal Reserve's ongoing efforts to control short-term interest rates are a confirmation that the central banks, in general, are losing control of the one aspect of interest rates that, in theory, was under their control pursuant to Keynesianism. The New York Federal Reserve has had to pour in hundreds of billions of dollars to keep interest rates down, and thus credit flowing through short-term money markets since mid-September 2019. If the Fed did not intervene, short-term rates would jump well beyond 10%.

Nevertheless, the Fed's interventions have signaled that there is a crisis in liquidity as banks no longer trust banks. This clash between the refusal to bail out banks in Europe means that a banking crisis in Europe could lead to a global contagion that takes banks down around the world. There have been rising concerns about the market's dependence on its daily doses of liquidity from the Fed, but these concerns miss the target completely and fail to comprehend the cause of this crisis.

The major point that seems to go over the heads of many is simply that this liquidity crisis is all about the political concerns in Europe, and the repo market is broken as banks no longer trust other banks because of the unknown counter-party risk.

The Lehman Brothers collapse began in repo, so that is what the banks remember. With the prospect of Europe vowing not to bail out banks, what would happen if Deutsche Bank failed and a U.S. bank had $100 million in exposure linked back to Deutsche Bank? Would Europe just refuse to cover their losses, as was the case with the Fed doing that with U.S. banks? That creates a situation where the Fed cannot bail out Deutsche Bank, and the best they could do is provide funding to cover losses in the U.S. banks as a result of Deutsche Bank.

To make matters worse, the great unknown is that you could be dealing with another European bank who then has exposure to Deutsche Bank, and consequently they cannot meet their obligation on another deal unrelated to derivatives at Deutsche Bank. The complexity becomes the great unknown as this has resulted in the Fed having to step in, not just to prevent short-term rates from rising, but to facilitate the entire short-term lending facility.

Obviously, this is not a long-term solution. More than $320 billion of total repo market support since September 17, 2019, was injected to keep the repo rate from exploding. Initially, the Fed injected roughly $75 billion in daily-lending facilities to keep the $1 trillion-daily U.S. Treasury repo market running. This market allows banks to pledge U.S. Treasuries or agency mortgage-backed securities with the New York Fed. The Fed has no choice but to keep banks stocked with cash to keep the financial system alive. Those who have focused only on the Fed's balance sheet expansion through monthly T-bill purchases have reported that this is just another QE. They fail to understand that something much more serious is lurking in the background. This is simply far bigger than most analysts thought because the bulk of these people are retail oriented, and not institutional. There is no retail participation in the repo market.

There is no question that the Fed has not figured out the problem because it began internationally. The domestic analysts believe that the Fed has created their own problem by continually injecting cash and equate this to a heroin addict who now cannot stop. Many domestic analysts think that the Fed should attempt to get the banks back to funding each other. They simply do not understand what is taking place on a major global scale.

The confusion emerges among the domestic analysts because they look at the numbers and can see that the big U.S. banks are hoarding cash because they have more than enough cash in excess reserves to meet regulatory issues. This only confuses them more for they have been scouring the numbers to find the next Lehman Brothers, but are coming up empty–handed. They do not comprehend why the big banks prefer having money at the Fed, where they can still earn 1.55%, rather than in the repo market. They are too domestically focused and do not understand what is taking place outside the United States.

Trump came out and said that the Fed should adopt negative interest rates. This clearly illustrated that Trump was unaware of the financial crisis brewing in Europe. Since he speaks with the heads of Europe, obviously they are unaware of what their policies set in motion. JPMorgan Chase (JPM) CEO Jamie Dimon commented on October 22, 2019, that negative interest rates have had "adverse consequences which we do not fully understand." Dimon warned that negative rates would be a bad idea if adopted in the United States or became a permanent part of international monetary policies.

In Congressional testimony, Randal Quarles, the Federal Reserve's point man on banking supervision, appeared to side with Dimon. Quarles said that the existing regulatory framework "may have created some incentives" that contributed to recent repo funding stress.

JPMorgan Chase's Jamie Dimon said that the turmoil in the financial system may be a precursor to a bigger crisis if the Federal Reserve does not learn from the experience. He used the opportunity to claim that the problems in money markets are exacerbated due to regulations that currently tie-up banks' extra cash parked at the Fed. He added that major money-center lenders could not step into the repo market at a key period due to regulations. He admitted, "We might have made the wrong interpretation [of the rules], it is possible. But I think we all were approximately at the same place on this."

The liquidity coverage requirements have been imposed on "too big to fail" banks, introduced by the Basle III banking rules after the 2008 financial crisis. This set of regulations is managed by the Federal Reserve and other U.S. banking regulators. They force lenders to curb how much they are willing to lend to other banks in short-term funding markets. Yet, this combined with the concerns over the impact of the refusal to bail out European banks has created a lethal combination as we head into 2020.

JPM is the largest of the primary dealers. It has radically shifted its balance sheet, reducing its cash position in favor of Treasuries. There is the Basel Committee on Banking Supervision (BCBS) that regulates what is known as the G–SIB (Global Systemically Important Banks) rating. This reduction in cash had the obvious impact of affecting G–SIB costs and subsequent G–SIB listings. However, another way of looking at this is that the amount of cash it alone could have lent has been drastically reduced as it stepped aside to let the Fed assume that role.

At the end of the second quarter, the amount of money JPM could lend on the repo market fell from $360 billion to $120 billion. This withdrawal needed to be found somewhere, and thus passed the demand around the street. This is clearly why the Fed had to increase its balance sheet by $250 billion in less than a two-week period. Confidence among banks has been declining because of Deutsche Bank and Europe's no bailout policy. Shifting to Treasuries rather than lending into the repo market is a reflection of the decline in confidence in the European banking system as a whole.

The typical analysis out there that claims this is just QE that will result in hyperinflation is plain nonsense. The hunt for which bank was in trouble had turned up nothing, for they were looking domestically. The comments floating around were pure speculation.

The crisis is expanding and the entire financial system that could be exposed to the liquidity crisis could reach $4 trillion based on total assets that banks hold at the Fed, repo auctions, the Treasury market, and other corporate assets. The total combined market is about $4 trillion. The repo market is the market where it all begins, for this is where even hedge funds and other institutional investors manage leveraged positions and borrow, which warns this could impact the share, bond, and commodity markets.

As we head into year-end 2019, the big banks typically attempt to shrink their balance sheets and avoid lending their funds at the end of the year or at quarter-end when regulators take a snapshot of capital levels to decide on the "global systemically important bank" (GSIB) scores for financial institutions. This juggling of money is window dressing to meet the Basel III accord.

The GSIB scores determine the extent to which a bank is required to carry additional capital on its balance sheet under Basel III regulations. Consequently, lenders, therefore, are mindful of their GSIB score and the impact it will have on the bank overall.

As a result, we have a liquidity crisis that is being created by the combination of Basel III and the refusal to bail out European banks. This could unleash a global contagion that becomes the Mother of All Financial Crises.

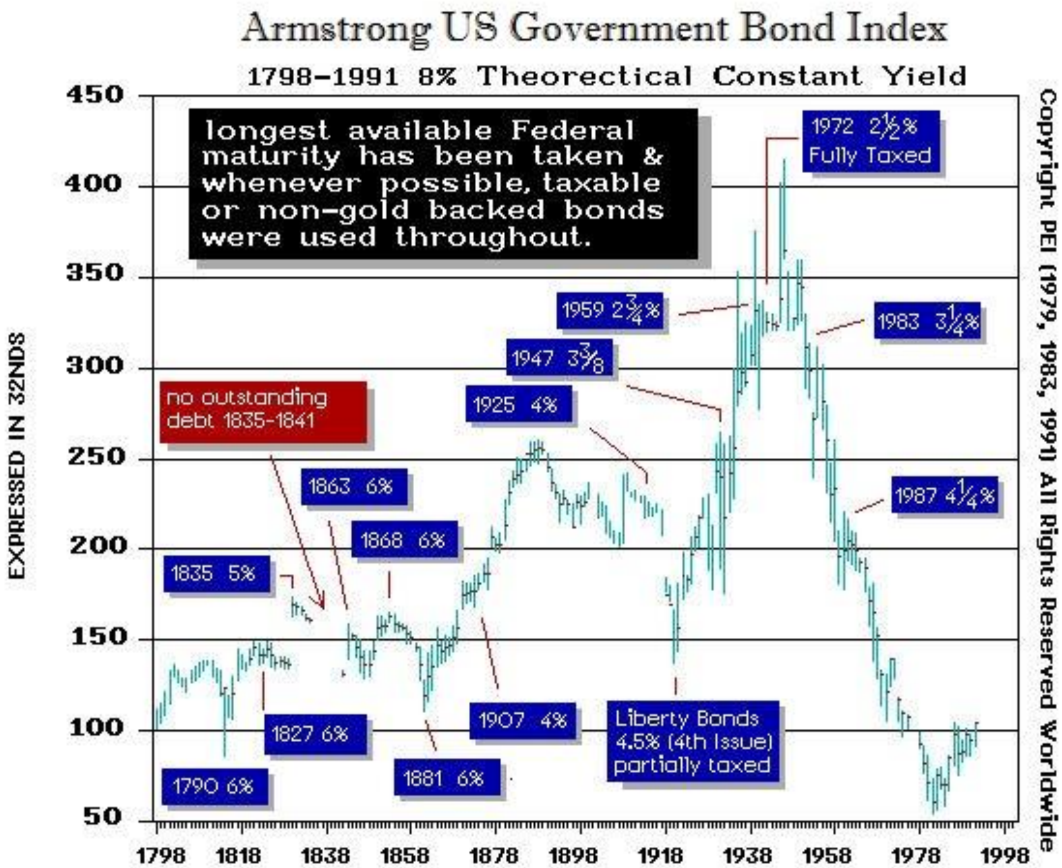
Mother of all Financial Crises

(Making the Mortgage-Backed Securities Just a Trial Run)

There is about $17 trillion in outstanding negative-yielding bonds. This adds yet another dimension to this Mother of all Financial Crises beyond the Basel III regulations and the refusal to bailout European banks. Suffice to say that the negative-yielding bonds are going to crash like something not witnessed since 1931. While a complete default is not likely prior to 2025/2026, we are going to witness the start of the collapse in 2020. These bonds have been bought by punters who are just trading them back and forth. But this is really a game of musical chairs. When the music stops, a lot of people will get caught holding these new 2.0 versions of financial debt bombs. Nobody is buying this debt with the intention of actually holding them to maturity. It is more akin to trading commodities where people are not actually interested in taking deliveries of lumber, hogs, silos of wheat, or bars of silver. These are trading instruments only.

What are the risks hidden in these negative-yielding debt instruments? The Repo Crisis is indicative of the true underlying trend to move back to normal, higher interest rates that reflect "risk" into the future. A normal person will not lend money out for 10 years if they believe that when returned, they will not be able to buy more than 50% of what they could currently. Interest rates reflect future risk!

This entire theory of lowering interest rates to stimulate demand is absurd for it has never worked even once. As long as people are uncertain about the future, they will not borrow or invest. This is when cash rises in purchasing power and assets decline because the expectation of the future remains questionable. This is when the demand for cash rises and the value of assets decline.



Present Value

No one is government has dared to consider this because they have never been investors or traders. When rates rise, outstanding bonds are discounted to adjust to the current level of interest rates. If we take present value of a bond that is not even negative and calculate that out 10 years, we would come up with about a 54% loss if rates reached 8% again.

The ideal high in interest rates appears to be coming in 2023/2024 with a target range maximum at 7.23% to 10.5% on the extreme end. It certainly does not appear as though the central banks will be able to prevent this rise in interest rates as we have witnessed in the sharp rise in repo to 10% during September 2019.

If we see rates hit the extreme end, then a 10-year bond with a zero yield would lose about 64% of its value without extreme fluctuations. Therefore, because we currently have $17 trillion of outstanding negative-yielding debt, the crisis in Sovereign Debt is going to make everything up to this point in time just a trial run for what will be the Mother of all Financial Crises.

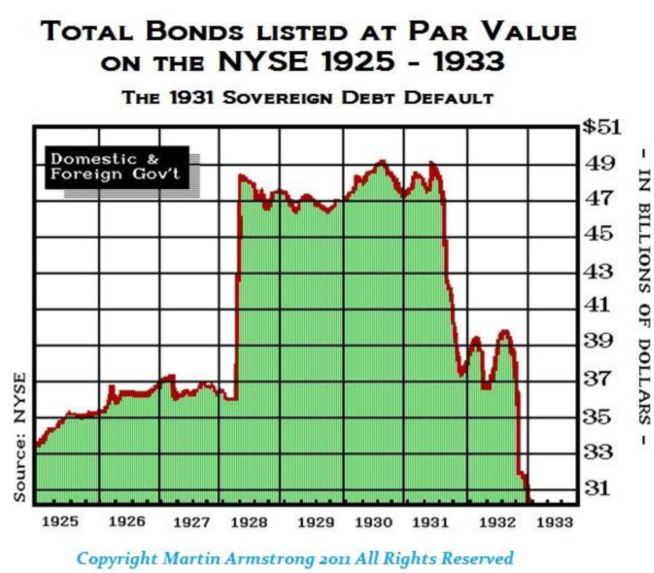
Present Value of 1 Table (PV of 1 Table)
Present Value Factors for 1.000 at Compound Interest
Rounded to three decimal places.

<u>Example</u>:
When interest is 8% per period and it is compounded each period, receiving 1.000 at the end of the 10th period has a present value of 0.463.

n	1%	2%	3%	4%	5%	6%	8%	10%	12%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.926	0.909	0.893
2	0.980	0.961	0.943	0.925	0.907	0.890	0.857	0.826	0.797
3	0.971	0.942	0.915	0.889	0.864	0.840	0.794	0.751	0.712
4	0.961	0.924	0.888	0.855	0.823	0.792	0.735	0.683	0.636
5	0.951	0.906	0.863	0.822	0.784	0.747	0.681	0.621	0.567
6	0.942	0.888	0.837	0.790	0.746	0.705	0.630	0.564	0.507
7	0.933	0.871	0.813	0.760	0.711	0.665	0.583	0.513	0.452
8	0.923	0.853	0.789	0.731	0.677	0.627	0.540	0.467	0.404
9	0.914	0.837	0.766	0.703	0.645	0.592	0.500	0.424	0.361
10	0.905	0.820	0.744	0.676	0.614	0.558	0.463	0.386	0.322
11	0.896	0.804	0.722	0.650	0.585	0.527	0.429	0.350	0.287
12	0.887	0.788	0.701	0.625	0.557	0.497	0.397	0.319	0.257
13	0.879	0.773	0.681	0.601	0.530	0.469	0.368	0.290	0.229
14	0.870	0.758	0.661	0.577	0.505	0.442	0.340	0.263	0.205
15	0.861	0.743	0.642	0.555	0.481	0.417	0.315	0.239	0.183
16	0.853	0.728	0.623	0.534	0.458	0.394	0.292	0.218	0.163
17	0.844	0.714	0.605	0.513	0.436	0.371	0.270	0.198	0.146
18	0.836	0.700	0.587	0.494	0.416	0.350	0.250	0.180	0.130
19	0.828	0.686	0.570	0.475	0.396	0.331	0.232	0.164	0.116
20	0.820	0.673	0.554	0.456	0.377	0.312	0.215	0.149	0.104
21	0.811	0.660	0.538	0.439	0.359	0.294	0.199	0.135	0.093
22	0.803	0.647	0.522	0.422	0.342	0.278	0.184	0.123	0.083
23	0.795	0.634	0.507	0.406	0.326	0.262	0.170	0.112	0.074
24	0.788	0.622	0.492	0.390	0.310	0.247	0.158	0.102	0.066
25	0.780	0.610	0.478	0.375	0.295	0.233	0.146	0.092	0.059
26	0.772	0.598	0.464	0.361	0.281	0.220	0.135	0.084	0.053
27	0.764	0.586	0.450	0.347	0.268	0.207	0.125	0.076	0.047
28	0.757	0.574	0.437	0.333	0.255	0.196	0.116	0.069	0.042
29	0.749	0.563	0.424	0.321	0.243	0.185	0.107	0.063	0.037
30	0.742	0.552	0.412	0.308	0.231	0.174	0.099	0.057	0.033

Musical Chairs

Since we are also dealing with institutions that have trading desks, the upper management has no clue about the risks involved. The short-term traders have never seen a Sovereign Debt Crisis, for most were not even around back in 2010. With a collapse in the present value of bonds, which is inevitable as we are dealing with $17 trillion just in negative-yielding debt, the losses to capital formation are staggering. We are right back to where we were in 1931 which created the Great Depression when sovereign debt listed on the exchanges defaulted and went to zero. This is a game of musical chairs which means the crisis is very fluid and who will fold depends upon current trading positions.



EUROPEAN CENTRAL BANK

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PRESS RELEASE

ECB introduces a negative deposit facility interest rate

5 June 2014

- Deposit facility interest rate cut effective as of 11 June 2014
- Negative rate to apply also to average reserve holdings in excess of the minimum reserve requirements and other deposits held with the Eurosystem

When deciding to lower the key ECB interest rates at its meeting today, the Governing Council of the ECB took the decision to cut the interest rate on the deposit facility to -0.10%.

There will be a custodial risk because a Sovereign Debt Crisis of this magnitude does not even require a default. Therefore, this is an admixture of the 1998 Liquidity Crisis that resulted from the Russian bond crisis, which led to worldwide liquidation to raise money, and the 2007–2009 Mortgage-Backed Security Crisis where the present value of the debt collapsed rather than defaulted.

The Sovereign Debt Crisis is part of Big Bang that began 2015.75. Interest rates went negative in on June 5, 2014, at the European Central Bank. This is what set in motion this Big Bang which should move into full swing by 2023/2024. Keep in mind we are not looking at an outright default, but the present value of debt will collapse and the only way to maintain the system will be for government to be the buyer.

The custodial risk will be unknown, for it will depend on who is holding the negative bonds when rates suddenly rise in the free market as they did in the repo market. Keep in mind that we are not looking at central banks actually raising rates. Instead, it will be a collapse in present value bonds that will imply that an increase in interest rates is demanded in the marketplace. The Fed has intervened by buying T–Bills to prevent short–term rates from rising. But the Fed cannot prevent rates from rising for the entire world. They have even less control over the Libor market, which is supposed to shut down by 2021.


Judge Martin Glenn

We do need to be concerned about judges who will undoubtedly try to defend the bankers. Judge Martin Glenn presided on M.F. Global bankruptcy and created the first bail–in without Congressional authority. He was the first one to engage in forced loans by abandoning the rule of law to help the bankers and protect Corzine from losses by taking client accounts to cover M.F. Global's losses. That is no different from what we saw in Cyprus. He simply allowed the confiscation of client funds when in fact the rule of law should have been that the bankers were responsible for M.F. Global's losses and it should have been reversed. Clients' funds should have never been taken for M.F. Global's losses to the NY bankers.

What Judge Martin Glenn's ruling warns is that you should not trust any company based in New York City. No other circuit would uphold what Glenn did to protect Corzine. While Glenn could not prosecute Corzine, the Department of Justice closed its eyes, as did the SEC and CFTC.

We lack legal integrity even in Europe. The EU high court had to uphold the ECB over the German challenge that they lacked statutory authority to engage in Quantitative Easing when they were prohibited from financing state debt.

The Bank Shares

When we look at the bank shares, we also get a sense of confirmation of the Repo Crisis. Deutsche Bank in U.S. dollars on the NYSE show important support in 2020 resting at $3.36. A sustained break of that level would suggest that Deutsche Bank may not survive. To be sustained, we would need two monthly closings below $3.36.

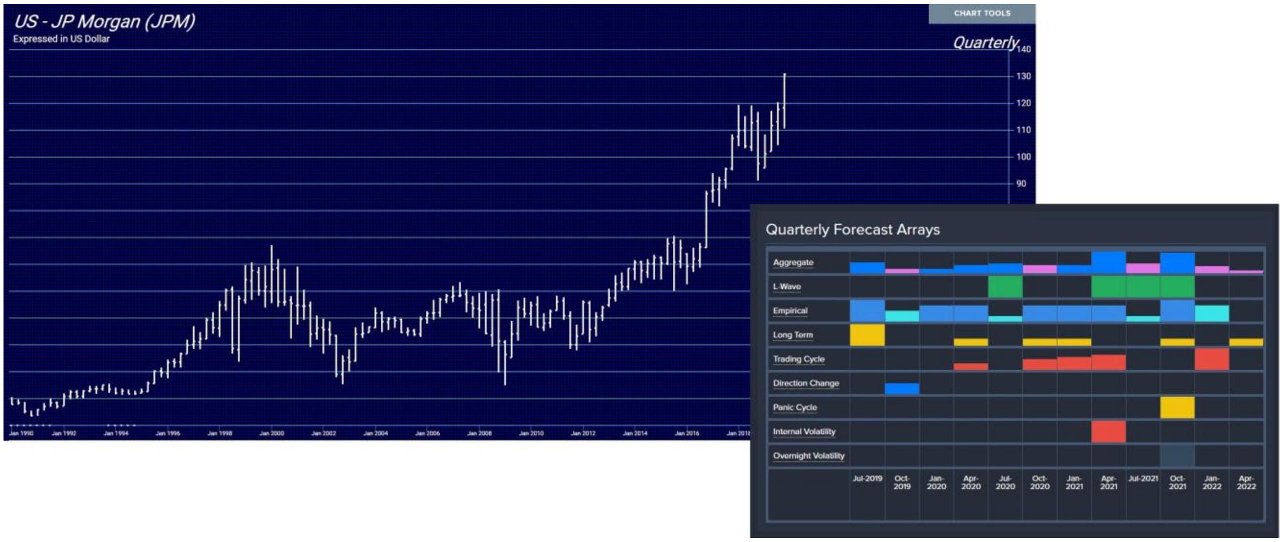
Deutsche Bank shares suggest that we may have a MAJOR turning point in 2020. That implies either the bank will collapse and come to an end, or Europe will have to revisit its no bailout policy. The implications of what they have unleashed means that no bank outside of Europe can risk dealing with them for there is now a serious COUNTRY RISK.

There has always been a gap between an international hedge fund manager who must stay on top of events globally and a simple domestic fund manager who just looks at the local headlines and the latest cryptic ramblings from the Federal Reserve. In the international arena, you must pay attention to everything everywhere. To be a real international hedge fund manager, you must be a cut above everyone else. You must pay attention to politics everywhere because that implicates **Country Risk**, which is the #1 criteria on investment strategy. If you cannot trust the rule of law in any country, then you cannot invest in the country. This is the real position that the EU has created with its no bailout policy.

Normally, country risk is reflected in the currency. When Europe created the Euro, they merely transferred the volatility in currency due to **Country Risk** over to the bond and share markets. Politicians simply do not understand how capital moves, nor do they comprehend the reason it will move. The foreign exchange markets have always been where the **Country Risk** has taken place. Once Europe tried to create a single currency to eliminate that volatility, they did not understand there is no way to eliminate this risk factor under modern Socialistic–Keynesianism.

Consequently, the creati9on of the Euro merely transferred all the volatility (**Country Risk**) to the share and bond markets. The denial of bailouts has further resulted in the pronounced decline in European bank shares compared to bank share in the United States. Why would someone invest in a bank that can go down and it can be seized by the government and sold for just €1?

The EU has failed to understand **Country Risk** and have tried to eliminate something that cannot be done in a free market system.



Looking at JP Morgan shares, we have been in a real bull market which has continued to make new highs, when Goldman Sachs' shares peaked during the first quarter of 2018. I am a firm believer that the markets instinctively forecast major future trends if you know how to read them. The market has obviously been looking at derivative exposure from Deutsche Bank since early 2018. The sophisticated marketplace has been aware of the growing threat of a European banking crisis. However, nobody will dare speak to the press out of fear that they will be blamed.

This subtle yet silent trend nobody will speak about publicly was first confirmed by the peak in Goldman Sachs shares in March 2018. Then during the November 2018, Goldman Sachs faced a number of lawsuits related to 1MDB, and Malaysia said it would seek a full refund of all of the fees paid to Goldman. As a result, the stock lost 15% in a single month. This was then followed by the inverted yield curve that began on March 25, 2019. Smart capital recognized that Goldman Sachs can actually collapse as they are being hit from two sides at once – Asia and Europe.

Indeed, there remains a risk that Goldman Sachs could collapse in 2023/2024 from a cyclical perspective (the firm was founded in 1869). Goldman went public on May 3rd, 1999 (1999.336). The 2018 high was precisely on target cyclically. A standard five to six-year decline would also agree with the long-term projection for 2023/2024. Based upon our cyclical models, it appears the bank with the greatest risk will be Goldman Sachs. Either Goldman Sachs fails, or it may be absorbed in 2025. Will bribing politicians prevent their demise again? They will fight hard and pull every string to stay alive. With enough bribes, they can hold in there if they can make it past 2025.

At year-end 2019, a closing above 199 in Goldman Sachs (GS) shares will keep the market neutral as 2019 has been an inside trading year and is holding above the 2018 low and below the 2018 high. To be bullish, GS needs a closing for 2019 above 250. Going into Thanksgiving week, GS has been trading at 220. It has not yet given up.

Our computer Array forecasts the fourth quarter of 2019 as a Directional Change in JPM, with turning points arriving in the third quarter of 2020 and the big one during the second quarter of 2021. Looking at the pattern difference with Goldman Sachs, there is obviously a major divergence. Goldman Sachs also does have a Directional Change in the fourth quarter of 2019 as well, warning that this Repo Crisis may indeed have a common impact.

Conclusion

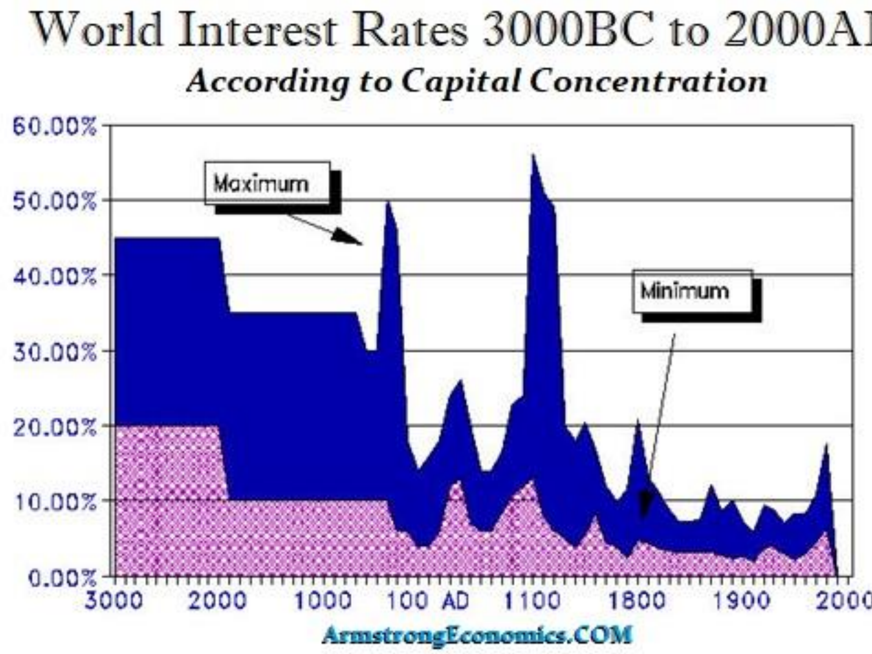
The Repo Crisis is not about showering money upon the economy in an effort to "stimulate" the demand. It is the beginning of what will become the Mother of All Financial Crises. The greatest risk here is that central banks used to be in control of the economy with short-term rates to impact demand. The Federal Reserve has lost control of the short-term rates, which is why they had to step in as the middleman and have been buying $60 billion in T-Bills per month to keep interest rates artificially low. But the Federal Reserve cannot manipulate interest rates for the entire world.

The greatest danger we face is waking up to the realization that central banks can no longer control the economy. Once that is understood in the marketplace, the fun and games will begin.

There are those who claim the Fed is engaging in Quantitative Easing because their balance sheet has increased. They point to the Fed buying $60 billion of Treasury bills per month, but completely fail to understand these are short-term T-Bills and not long-term debt. The Fed has simply been trying to keep short-term rates from rising, which is an entirely different purpose as distinguished from Quantitative Easing to "stimulate" the economy.

Clearly, the Fed is trying to prevent short-term rates from rising, demonstrating that they are also losing control of the short-term rates. The 2007-2009 QE was an attempt to "stimulate" the economy by purchasing long-term bonds in hopes of lowering long-term rates. They assumed, wrongly, that by reducing the supply of long-term bonds, the banks would then be encouraged to lend into the mortgage market helping real estate. Their wishful thinking never materialized.

This time the Fed is clearly trying to prevent repo rates from rising to 10% or higher again because the banks do not trust banks. We are witnessing the Fed trying to maintain control over the benchmark short-term interest rate it uses to guide monetary policy. They are not "stimulating" the economy, bailing out banks, or buying US debt because others will not. Those are all nonsense excuses.



The Repo Crisis has nothing to do with the economy domestically in the United States nor is it Quantitative Easing to stimulate the economy by buying in debt. The Fed is desperately trying to prevent short-term rates from rising when we are at a 5,000-year low in interest rates. This is a battle for control they cannot win.

We must be aware, as we head into year-end, our point of focus should once again be on the repo market. We must keep in mind that the effects of the overnight repo are not exclusively limited to the fixed-income market. The repo rate has the potential to escalate and influence all markets, which is why the Fed has stepped in. When institutions need money, they sell what they can and not what they should. The repo rate can impact equity derivatives, FX forwards, as well as fixed-income and commodities. This has the potential to lead to absolute confusion.

During September 2019, we saw the overnight rate climb to 10%, but because of Fed intervention, rather than the subsequent rate cut, the crisis did not spread to the mainstream headlines since most never heard of repo until September 2019. By year-end, mainstream headlines will be aware of repo these days especially if it can be spun against Trump.

JPMorgan Chase (JPM) is the largest of the primary dealers. As previously stated, JPM is the largest primary dealer and they shifted their balance sheet, reducing its cash position in favor of U.S. treasuries. This was clearly done because of the Basel III regulations out of the Bank of International Settlements (BIS) under their Global Systemically Important Bank rating (G–SIB) rating system established after the 2007–2009 financial crisis. JPM was looking at their G–SIB listing. Consequently, Basel III resulted in JPM reducing the amount of cash it would lend in REPO from $360bn down to $120bn thereby forcing the Fed to make up the difference. They did not even report this aspect again they remain clueless and were talking about tax payments due.

Reuters reported back in 2015 that JPMorgan Chase & Co had the highest potential risk within the financial system among all US banks. JPM had the highest numerical risk ranking of U.S. banks according to the 2015 US Treasury study.

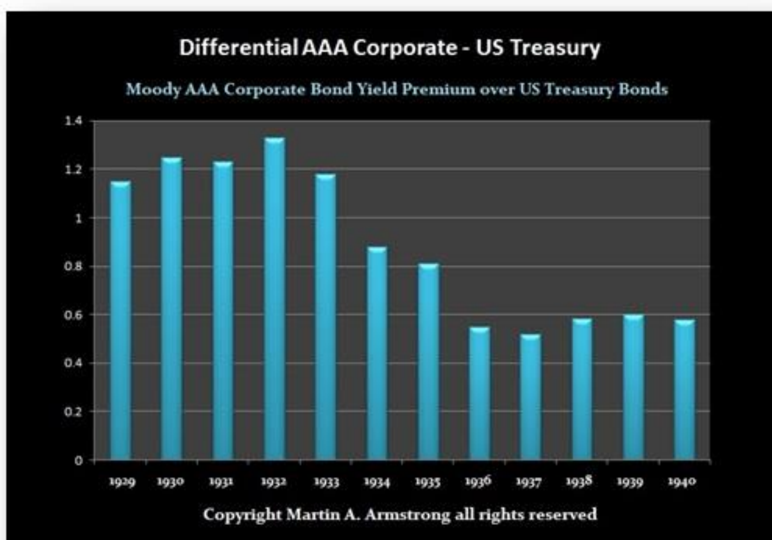
What JPM achieved beyond Basel III regulations was to reduce its possible counterparty risk in light of a potential Deutsche Bank moment. Yes, the G–SIB listing declines and its cost to borrow increases. Therefore, swapping treasuries for loans, mortgages, and cash does improve counterparty risk as we head into the turbulence potential for year–end 2019. At the same time, JPM reduces its lending deferring to the Federal Reserve to provide that liquidity. More importantly, this places the Fed on a collision course with the free market and probably a direct confrontation with the ECB unless Legarde can get Germany to blink on the no bailout policy.

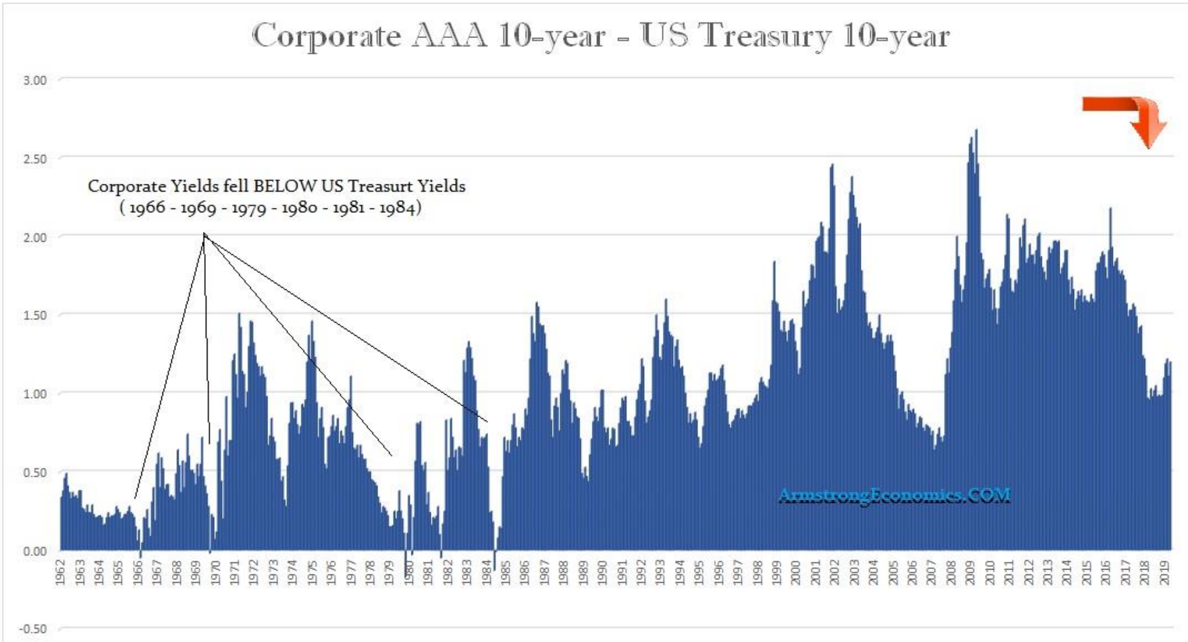
Bank reserves will become even more of a sensitive issue in 2020 and ahead of US elections. The market pundits are pressing for more QE lacking any understanding of what this is all about. There remains a serious question as to if the Fed realizes what is fully at stake here and the extreme danger negative yielding bonds represent. The fact that these are sovereign bonds does not lend itself to pointing to the private sector or bankers are the cause of this mother of all financial crises. The Fed is being backed into a corner by Basel III and the growing concern for the European policy of no bailouts.

The risk the Fed faces is that they are not in a position to control the damage when it is external to the U.S. market. In the final analysis, the Fed will be unable to hold up the entire world economy and this increases the risk of a dollar rally to new highs as capital flees the banking sector makes a run for private assets.

Clearly, the Repo Crisis is serious, but it is warning that the Federal Reserve has lost control of the short-term interest rate market, whereas the 2007–2009 Crisis was all about the long-term market. The Fed cannot hold up the entire world and this rise in the Repo Rate is a direct assault upon the last vestige of power residing in the Federal Reserve. The ECB and the Bank of Japan have both destroyed their respective bond banks. There is no possible way to restore that without allowing interest rates to rise once again to normal levels.

One aspect of this Mother of all Financial Crises will be the shift from public to private debt. This is also what took place during the Great Depression. When there has been concern that governments simply default, the smart capital moves to private debt. The spread between AAA corporate and Treasury declined during the Great Depression, which was contrary to popular belief that was spun by the socialists.





Once again, we see the spread between AAA corporate and public debt has been declining. Historically there have been several times when AAA corporate paper even moved below that of government in the United States no less. We should expect that trend to be even more pronounced in the years ahead in the Eurozone.

Clearly, there has been a lot of confusion over the Repo Crisis primarily because those offering comments know nothing about what is taking place behind the curtain. There is a growing deep concern among the smart money which they cannot articulate publicly. Banks no longer trust banks because nobody is talking, and everyone is trying to keep quiet as to not set off a crisis that is likely to be the Mother of all Financial Crises.

We have a serious shortage of dollars that has been building behind the curtain as well because of the growing concern also manifesting in the FOREX markets. The euro, with negative interest rates, has done far more damage than just destroying its local bond market. It is creating a time bomb of $17 trillion of negative bonds that are likely to collapse in present value by 64% on

average. The loss in capital formation of this magnitude will severely impact custodians holding euro-denominated debt in general. Don't forget that 9,000 banks failed during the Great Depression in the United States as a result of the collapse in sovereign debt in 1931.

The collapse in negative interest debt will be similar to that of the collapse in mortgage-backed securities during the 2007–2009 crisis. It does not require a rise in interest rates by the central banks. All it takes is a collapse in confidence in a particular variety of a debt instrument. This is the most likely outcome we see coming in the near future with respect to the negative interest rate denominated securities.

The risk of a collapse in Deutsche Bank is really defined at the critical support level at $3.36 on the NYSE. A monthly closing below that level would warn that there is a risk of default. Nevertheless, because of the political implications worldwide as a result of the failure of Europe to bailout Deutsche Bank may rise to the level of a true international political crises. We should expect see the likely result of total political chaos unfold putting pressure on Europe to bailout its banking system. If Europe rejects this position, then it would become possible for Deutsche Bank to collapse. Hopefully, the European government, and Germany, will blink.

Currently, Treasury Secretary Steven Mnuchin has been collaborating with the Federal Reserve to monitor lender reserves and curtail another Repo Rate crisis similar to September's 2019. So, now we also have the U.S. Treasury stepping in to try to come to the aid of the Federal Reserve. This is indicative of the crisis becoming much more pronounced from a liquidity crisis. The next shoe to fall will be the negative bond crisis which can unleash a profound crisis which will be the **Mother of all Financial Crises.** We are looking at a serious long-term impact about to unfold over the next few decades moving into 2032.

There will of course be those advocating a return to a gold standard. That is simply out of the question. In order to adopt such a monetary system means politicians can no longer run for office promising some benefit bribing the public. The days of the gold standard as a solution are long gone. We now face the reality of negative interest yielding bonds and what they will be worth when rates rise. The Repo Crisis was all about short-term rates spiking higher forcing the Federal Reserve to provide liquidity or it would never again be able to raise of lower interest rates under the Keynesian Model to control the economy.

Once the understanding that the central banks are not in control as what took place following the Louvre Accord in February 1987, the currency crisis manifested in the wholesale selling of dollars which became the Crash of 1987.