LMR

BUILDING THE 10%

OCTOBER • 2019

PULSE ON THE MARKET

Europe's Genuine Austerity

Fed Continues Inflating

Warren's Whopper

CHARITABLE GIVING USING IBC

by L. Carlos Lara

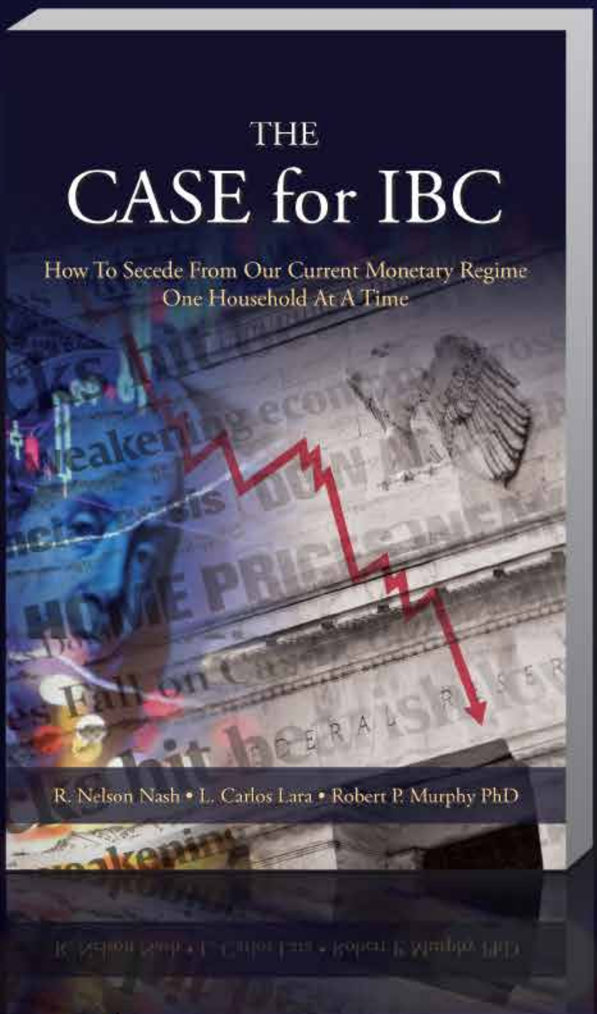
WHY I CASHED OUT MY 403(b)

by Robert P. Murphy

TO UNDERSTAND THE MONETARY SYSTEM, THINK GLOBALLY

Interview with Jeffrey Snider

Something is FUNDAMENTALLY WRONG with our financial system.

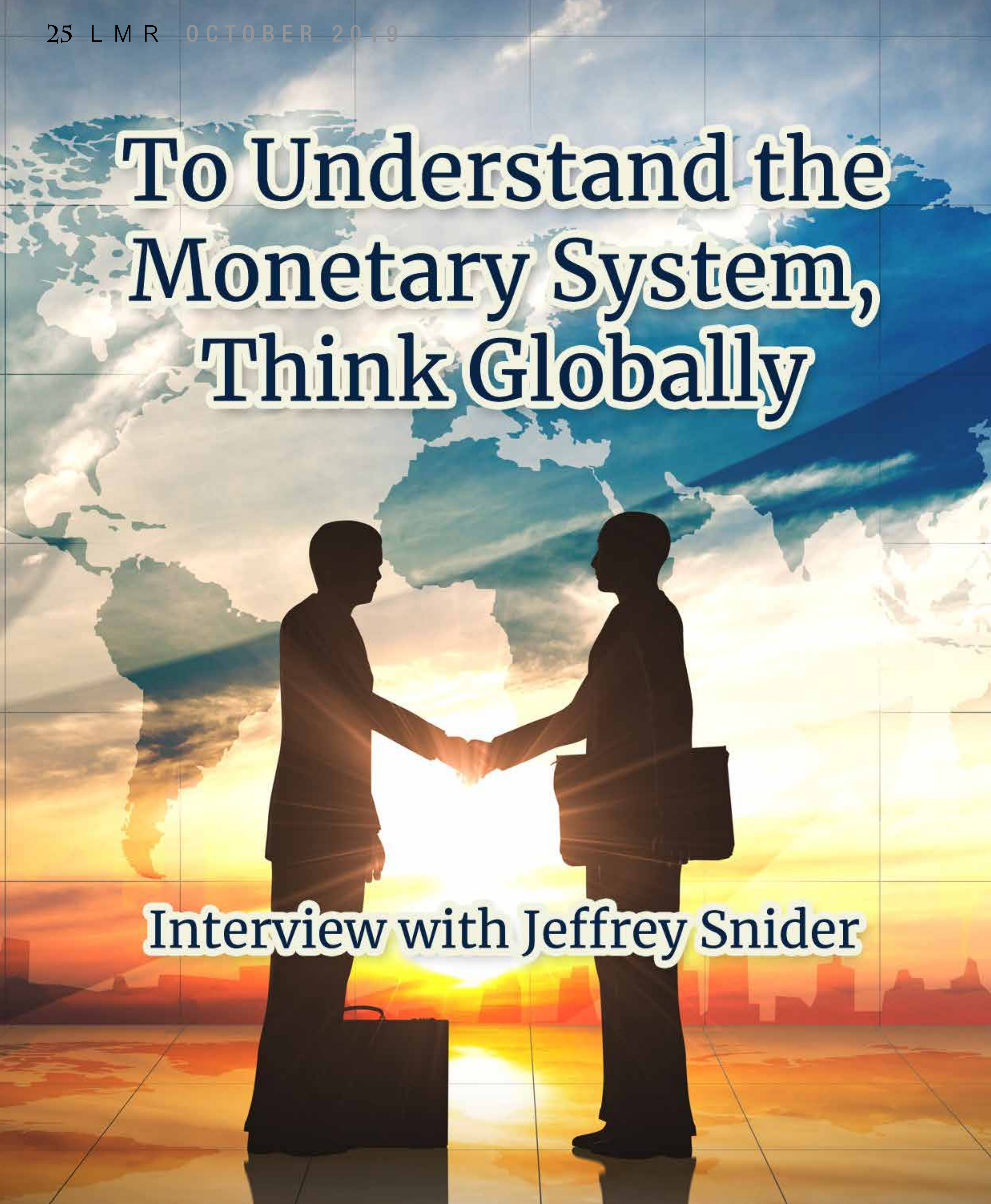


R. Nelson Nash's Infinite Banking Concept (IBC) is a revolutionary method to take the banking function away from the "experts" and return it to the individual household and business owner.

In *The Case for IBC*, Nash is joined by business consultant L. Carlos Lara and economist Robert P. Murphy to provide the most succinct explanation to date of why IBC works.

Order The Case for IBC Now

www.thecaseforibc.com



To Understand the Monetary System, Think Globally

Interview with Jeffrey Snider

Jeffrey Snider is the Head of Global Research at Alhambra Investments. Though his work makes it sound like he is an economist, he claims no such thing. Rather, through intense personal study he has developed a very different sense of especially the hidden inner workings of the global monetary system—beginning with the fact that it is a global money system.

Lara-Murphy Report: How did you discover Austrian economics?

Jeff Snider: I had a professor in college who was unconventional in both his style of teaching as well as what he taught. He had been the only one who had suggested that there were other ways beyond the orthodox view of looking at the world. Sound money, malinvestment, and, most of all, the pretense of knowledge.

It was the last one which really registered with me. I had gone into economics hoping to learn something about, you know, the economy and whatnot. Instead, it was models, math, and statistics. Simple regressions based on subjective assumptions and we were supposed to believe that these would allow anyone with a few equations to compute precise, predictable outcomes.

> "It was later that I discovered things like chaos theory and fractals which made intuitive sense to me, the unpredictability of complex systems that Friedrich Hayek had written about right at the time econometrics was taking over."

It was later that I discovered things like chaos theory and fractals which made intuitive sense to me, the unpredictability of complex systems that Friedrich Hayek had written about right at the time econometrics was taking over.

LMR: The Fed has continued to intervene in the repo markets, even though some analysts originally assured the public that the spiking interest rates in mid-September were one-off events, such as corporate tax bills coming due. You were publishing research on the repo (and related markets) for some time now, well before others were paying attention. Do you think the instability in the repo market signifies deeper problems?

"In September, there is lower low point [of liquidity] that relates to the factors you and everyone else has cited. But here's the thing: everyone knows about them well in advance. This wasn't some surprise shock event."

JS: Yes, and there are several issues which have been conflated and misconstrued to make it seem like there is nothing going on here. The first is the technical factors being cited. Those are, were, very real. There are seasonal low points in terms of liquidity scattered throughout the yearly calendar. Everyone knows about quarter-end window dressing, for instance.

In September, there is lower low point [of liquidity] that relates to the factors you and everyone else has cited. But here's the thing: everyone knows about them well in advance. This wasn't some surprise shock event. Anyone who is participating in liquidity markets had a nearly precise idea of just how much these factors would subtract from capacity, almost down to the penny.

And still, "something" unusual happened anyway. The seasonal low point wasn't the cause of the repo event, it *exposed* deeper problems in the global liquidity structure. A shyness among money dealers to provide liquidity as needed that has been increasingly evident going back to the early months of *2018.*

Fed funds and repo rates have been moving higher (spreads) along with the appearance of other fundamental liquidity indications suggesting negative pressures. Together, these have told us that dealers were more and more reluctant to deal in liquidity long before September 2019.

"So, instead of wondering about corporate taxes and the level of bank reserves the Fed operates, we have to ask ourselves about what it is that might be causing these insider dealer participants to sit on their hands even when there are enormous spreads sitting there in front of them."

So, instead of wondering about corporate taxes and the level of bank reserves the Fed operates, we have to ask ourselves about what it is that might be causing these insider dealer participants to sit on their hands even when there are enormous spreads sitting there in front of them, the unusually high repo and fed funds rates on an otherwise predictable low point in the seasonal calendar. That's the real issue, the one that the Fed can't do much about (and, by the way, hasn't).

LMR: In your writings you have pointed out that the Fed all along had a mechanism by which borrowers could obtain short-term loans if they put up good collateral: the discount window. Yet during both the financial crisis of 2008 and now, the discount window has been ignored while the Fed comes up with new programs, such as the Term Auction Facility (TAF) back in 2007-08, and the large repo operations now. Can you explain what's going on here?

JS: The Discount Window, which was effectively and purposefully rebranded as Primary Credit all the way back in 2003, is the Fed's standing mechanism for its lender-of-last-resort function. But there will never be a time when anyone will use it in any size. Everyone knows that, because use of Primary Credit is transparent, the day you go to the Fed for funding it is your last day in business.

Stigma.

"Once the rest of the marketplace sees your name published on the Primary Credit roll, it will immediately be assumed that you are a deeply troubled institution and whatever marginal funding you've been able to piece together to remain afloat to that point will disappear the day after the Fed publishes the list of Primary Credit borrowers."

Once the rest of the marketplace sees your name published on the Primary Credit roll, it will immediately be assumed that you are a deeply troubled institution and whatever marginal funding you've been able to piece together to remain afloat to that point will disappear the day after the Fed publishes the list of Primary Credit borrowers.

Without a standing facility to take care of any potential trouble spots, it has left the central bank to become more creative; some might say contradictory. Transparency, central bankers tell us, is an unqualified good thing and yet here they are designing ways to preserve absolute anonymity. To hide names and even amounts (by designing liquidity programs that "everyone" is encouraged to borrow/fund from at round number allotments in order to disguise how much of a shortfall might actually be taking place), to obfuscate as funding strains emerge.

The Fed did this originally in December 2007 with TAF auctions; a blanket $25 billion (times two) auction of "liquidity" under cover of anonymity (it was only years later that the auction list was forced into the public, only for the public to discover that it was, by far, US subsidiaries of foreign banks who were so short of dollar funding). By purposefully keeping things under the surface so that "the market" could never tell at least by the Fed's actions just how serious things had become.

> "The reason there was a Global Financial Crisis in 2008, the only reason there could have been, was that there exists a global monetary system operating largely in the shadows offshore."

It isn't exactly analogous, but the overnight repo operations and now the not-QE small-scale asset purchase plan include many of those same elements for the same reasons. The Fed can tell you that there is nothing to see here at the same time they won't give you any information which might show otherwise. Just a bunch of dealer banks bidding for the same overall amount of funding.

In the repo operations, the Fed has offered and continues to offer round number allotments (originally $75 billion, now interestingly increased to $145 billion) which are bid on, in a recent twist, only by the 24 primary dealers. Authorities are not intervening in repo—at all. Instead, they are increasing the level of bank reserves those 24 dealers have access to with the idea that they will then lend these new reserves in repo and fed funds to "anyone" who might need the funding.

No one but private primary dealers need know anything about those "anyones."

Like TAF, the purpose isn't necessarily technical and immediate funding requirements, the real purpose of the repo operations and not-QE is to reassure the public that things are being handled so long as you don't think too deeply about how.

LMR: One of the apparent problems with the theory blaming the financial crisis of 2008 on the U.S. housing bubble is that the crisis was a *global* phenomenon. How do you explain this in your framework?

> "Every single market indication, every liquidity indication, uniformly and unequivocally declares that we still have a global dollar problem no matter how many QEs or the level of bank reserves (into the trillions)."

JS: Subprime mortgages were never, ever enough to create so much damage and havoc in the US let alone spread out globally—permanent and lasting damage. When you looked at the list of who it was that had been bidding for TAF liquidity, for example, you found out that the names were mostly German and European banks (their US subsidiaries). On top of that, the Fed was conducting overseas US$ swaps with primarily European central banks (along with the Japanese).

Why were financial institutions spread all throughout the world so desperate for, of all things, US$ funding?

The reason there was a *Global* Financial Crisis in 2008, the only reason there could have been, was that there exists a global monetary system operating largely in the shadows offshore. That's what the term eurodollar means—offshore dollars.

It has taken on very strange forms in that it is entirely an interbank system, a network of bank liabilities that span the globe, all denominated in US dollars. It is a ledger system, almost virtual currency because it contains little if any physical US dollars within it.

Without any effective lender-of-last-resort (for several reasons, including the problems with Primary Credit), there was no effective means to handle what was really simple, traditional currency inelasticity. A global dollar shortage already sounds strange, but one where there are no dollars nor any effective central bank operating within it presents a whole variety of negative potential factors.

And they, not subprime mortgages, combined to give us the world's first large-scale bank panic since the Great Depression. But it wasn't like prior versions throughout history; there were *only banks panicking*. Unlike the thirties, there were no long lines of regular everyday folks queued up outside of ATMs desperately trying to convert deposit liabilities into currency and cash.

Again, this was an interbank market breakdown. It was long lines of interbank counterparties desperate to cut ties with anyone who couldn't otherwise liquify their assets—of all kinds, not just subprime MBS—who were then left in the funding wilderness with only increasingly negative methods to try and stay afloat.

Without any means to intervene, the system's fate was probably sealed once subprime mortgages, really subprime MBS structures and the way they were funded (globally offshore), began to be reconsidered. Subprime wasn't the crisis, it was merely the first catalyst for doubting the way in which this global offshore dollar system had worked.

LMR: Finally, what do you think most financial commentary is missing? Is there a major myth or misconception that plagues the typical reporting on financial markets?

JS: There is no account for the actual monetary system as it is, there are only assumptions and shorthand. We are all taught from the very beginning, "Don't fight the Fed." Why?

We are supposed to just believe that because Ben Bernanke in November 2002 said the Fed possesses the mythical printing press therefore the central bank, any central bank, has the money side of things covered and handled. It was the myth of the "maestro," Alan Greenspan, after all.

But how do we reconcile that view with the somehow Global Financial Crisis? At the very least, people should get the feeling that even central bankers must've missed *something big*. The very fact that 2008 happened at all, demonstrated conclusively that there are large gaps in how we understand the modern financial system.

Rather than investigate those gaps, in the post-crisis era the public has instead been put back to sleep by the dazzle surrounding quantitative easing, or QE. It must have been "money printing" because everyone says it was.

And yet, every single market indication, every liquidity indication, uniformly and unequivocally declares that we still have a global dollar problem no matter how many QEs or the level of bank reserves (into the trillions). The bond market, which is more than bonds and is made up of these very same global banks in question, has been telling you and anyone open enough to listen that QE wasn't money printing. At best, it was an asset swap (and arguably a hurtful one).

Rather than figure out for ourselves how things really work in the money system, we are supposed to just fall back on the myth of the "maestro." No matter how badly things turn out, no matter how many obvious contradictions like predictable calendar low points turning into a global front page story, we are just supposed to believe that central banks have it all covered no matter how many times it's pretty obvious that they don't.

I don't think this is *exactly* what Hayek had in mind when he talked about the pretense of knowledge, but it sure follows the mainstream course laid out all that time ago that he had been criticizing.

◆◆◆

Note: The economists and financial professionals interviewed in the LMR are given the freedom to express their views, without necessarily implying endorsement from the editors.