Europe's QE Suicide! Escalating Debt and Outright Monetization

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As you now know, Europe is set to announce a new QE program. I wish these money printing rocket scientists would call it like it really is, outright monetization but then again the average non thinking person might ask questions? The leak yesterday said the size would be 50 billion euros per month, or more (it turned out to be 60 billion). Thinking about this from a far away view, we can glean a few hilarious aspects.

First, let's look at "size". If the program is "only" (more was expected) 60 billion euros per month, this will amount to around 720 billion additional euros outstanding a year from now. From a "money perspective", this amount is far less than the QE 3 the Fed just publicly (privately maybe not) ended and smaller than the current Japanese operation. The markets may view this as "smaller than hoped for", I of course have a different perspective. If we add up the production of all gold globally from the mines, we come to a ballpark number of a whopping $100 billion. Compare this to the (newly devalued) figure of 720 billion euros and we can round this off to just over $900 billion. So, in just one year, Europe will create nine times the amount of trash currency as the entire world creates of gold …in one year! The ECB plans to purchase this amount of debt for two years, nearly $2 trillion worth!

Going just a step further, let's look at this $100 billion worth of gold which is produced annually. I am going to tell you that as far as the "world" is concerned, there is NO new gold produced! How can I say this? All you need to do is look at how much gold just China and India combined take off the markets each year. The answer is "all of it"! Actually, that's not true unless we add the phrase "and then some"! So from a size standpoint, Europe is proposing to create nine times the amount of currency as new gold is produced, yet none of the gold even hits the market to add to the current stock. Yes I know, there will be those amongst you who say this is wrong. But is it really wrong if 100%+ of new gold supply gets devoured and vaulted by China and India never to see the light of day again? Yes it is "stock" but it will never in our lifetimes "flow"!

Let's now look at few of the other "little snags" in this European brainchild. First, can Europe handle more debt collectively and what about the ones who cannot? The ECB is proposing a "one for all and all for one" strategy when it comes to responsibility to this debt, will the Germans agree to this? What will happens when push comes to shove and countries with no financial wherewithal just shrug their shoulders when they cannot make the debt service payments? Does this mean that Germany becomes the "one for all"? Wasn't it just a couple of years ago the PIGS debt was on the verge of collapse and rates were skyrocketing? Have they really healed their balance sheets or do they now have MORE debt and HIGHER debt ratios? Are we to believe they are now safer? One last thought, the ECB is the central bank to Europe, should they really be prompting their flock into issuing more of the poison that caused the problem in the first place?

Another question becomes, what about Greece? Will the ECB purchase their bonds? What if Greece's elections finish and the winning party decides to hold the ECB ransom "restructure our debt or we will default …or just take our ball and leave"? How is this going to be handled? Another aspect going back to "size" is that the 720 billion euro QE will be three times or more the size of current issuance, isn't this the reason the Fed was more or less forced to stop QE …because they were taking too much collateral out of the system? Will this force banks to purchase lower credit quality debt in their reserves or does it just mean interest rates all throughout Europe will be negative? Does this mean investors will "pay" interest to insolvent deadbeat nations like Portugal, Spain and Italy amongst others? I know it sounds quite strange to have to pay interest on your lent money to an insolvent entity, but this is where we are headed!

While we are on the topic, what about "negative interest rates"? To begin with, if you think about it negative interest rates cannot last forever or even for a long time because it means the lenders in the end will lose all their money. (From a humorous standpoint, maybe this is a good thing because at least they lose all their money "slowly" rather than all at once!) Also from a Mother Nature standpoint, only the very best money does not need to pay interest, all the rest do and the interest rate is decided by the risk of creditworthiness and strength of currency. In this instance, they are all the same sloppy currency but Greece is not Germany even if they do both begin with a G. If negative interest rates were normal, borrowers would end up with everything and lenders would become extinct.

Also, wouldn't this hurt the banking sector in another way than just making collateral impossible to find? Wouldn't the smart ones just go into their bank and withdraw everything and hoard the cash which wouldn't require the constant haircut of negative rates? What does this say about velocity?

All of the above questions and thoughts were things the Swiss have thought about for years. The "commonality" was a problem for them and they decided not to join the EU in the first place. Now, the Swiss National Bank has looked at this current scheme and decided to cut their losses. Why should they continue to purchase euros if they know the official policy is to debase and ultimately ruin them? The Swiss have made a decision, my topic for tomorrow will be "The 'neutral' Swiss seem to have chosen sides" as they announced a new renmimbi hub based in Zurich. Do you think they might have known about this last Thursday when they pulled the plug (peg) on the euro?

One more question or two before we finish, why does Europe even need to do this now anyway? Hasn't their currency already substantially weakened versus the rest of the world and grossly versus the Swiss? Isn't this "REALLY" what QE is all about? Weakening your currency faster than your neighbor so you can steal his market share of exports?

In reality, Europe is playing Russian roulette with a fully loaded gun! Their currency is already weak, yet they want it weaker. They are already broke, yet they want to become broke(r). Rates are already substantially negative but apparently not negative enough. Good (if you want to call it that) quality collateral is already scarce, yet they want to take more from the banking and shadow banking systems. Germany is already not in such a good mood as to what has already been done, yet the ECB wants to rub salt in the wound of the very core of Europe.

In my opinion, this announcement of QE is a very bad choice and very poor experiment. QE has not worked anywhere else in the world, why will they be any different? Before they even announced this they had already received two very important and fully negative votes. The Swiss have abandoned them and gold has exploded higher and broken out to the upside. Maybe they are more fearful of the market hearing Mr. Draghi say "we were just kidding"? He has promised this bazooka for several years and jawboned the markets higher each time it looked like fullout collapse was imminent. Now they will fire this so called bazooka, the worst possible immediate outcome would be for their markets to spasm downward in response. Speaking of "response", isn't it curious the ECB "leaked" 50 billion euros yesterday? I am here to tell you, they floated that trial balloon because they were fearful of the response. When the market didn't go spastic, they upped it another 10 billion for good measure! The ECB is in a panic, otherwise no "leak" would ever have appeared. They have lost control, they know it, it is only a matter of time before the markets realize it.

We have already experienced huge volatility which has certainly made some participants insolvent. As I see it, this new episode lays the track towards even more volatility. High volatility in a system that's quite low on liquidity and quality collateral in the first place is a toxic recipe. This will definitely not end well though it may end very abruptly when it does!

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Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in late 2006 to avoid potential liabilities related to management of paper assets. In retirement he and his family moved to Costa Rica where he lived until 2011 when he moved back to the United States. Bill was a well-known contributor to the Gold Anti-Trust Action Committee (GATA) commentaries from 2007-present.