Upcoming Currency Crisis? The Contradictions of Europe's "Negative Interest Rate Policy"

Is Zero Better than Nothing?

By Bill Holter
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NIRP, "negative interest rate policy", what an interesting concept this is. Last week the ECB announced a 10 basis point "cut" in their deposit rates for banks who hold balances at the ECB. The lowered rate now makes the rate a negative .20%. Let's take a look at this from a few different viewpoints to see exactly how humorous and ridiculous this is.

I do want to point out that this stupidity is a "Western plague" and not a global infection as interest rates are still solidly positive in most Eastern nations. Yes I know, the apologists will say "of course interest rates are positive in the East, this is to compensate for the extra risk". Really? How much "compensation" is there in the bond market that gobbled up several billion euro's worth of Spanish bonds? These bonds were priced at 4% and mature in 50 years, if you recall it was only two years ago when the markets blew Spanish 10 rates to nearly 8% …they were broke then …they are much more "broker" now! Yes, "compensation"…

Simon Black put out a piece last Thursday which spoofed the Australian bank ANZ for actually advertising "0%" interest rates on deposits, all deposits no matter what currency they were in.
. http://www.zerohedge.com/news/2014-09-05/everything-thats-wrong-banking-summed-one-bonehead-advertisement

I have to ask why anyone would consider a 1 year, 2 year, 5 year or especially a 10 year CD with a zero percent interest, is this supposed to be a good thing?

Why would anyone want a long term account at zero percent when they could have a checking account that pays zero?

Are people really worried about rates going deeply negative so "zero is better than nothing"? Maybe compared to a negative rate it is but think this through, you are adding "risk" to your cash holdings and either not getting anything in return or actually paying (in the case of negative rates) for the "privilege" of losing money.

The alternative of course is to withdraw all of your funds and bury them in a hole somewhere, at least this way you are assured not to get stuck with negative rates and you don't have to be worried about your bank going under. My point is this, if you are not getting anything to compensate you for taking on counterparty risk, then why take the risk? Even worse, if rates are negative…you are actually PAYING for the risk! Does this make any sense at all?

From another angle, we know there is inflation out there. In the U.S. we are told that inflation is “too low” and still under 2%. Have you bought any steak lately? Or fish, shrimp, pork or chicken? The real inflation number is probably very close to 10% but for this exercise let’s assume a bogus 2% rate. At 2% compounded your “money” (cash) will lose close to half of its purchasing power in 20-25 years, what if you also locked in negative rates to boot? Now you are looking at a purchasing power of about 1/3rd of what you have today, does this make any sense? Again, why would anyone do this? Why in the first place would someone hold their savings in any currency that depreciates? Then, why would someone actually accept negative interest rates when this amounts to paying the bank to “hold” your balance? Actually, when you deposit money to a bank, you are lending to them and they are borrowing …so in reality you are paying the bank to borrow your money? I’m pretty sure I could never have explained this concept to 10 or 12 year old who cut lawns and shoveled driveways to earn money back in the 1960’s.

Before going any further I had a funny thought, if this is how banking works then why not borrow money at negative rates yourself? The more you borrow the more you get paid or stated another way, “whoever has the most debt wins”. The answer of course it you cannot borrow at negative rates because you are not a bank and ONLY banks are allowed to rape and pillage …while telling you “it’s a good thing”!

The “goal” of these negative interest rates of course are to kick start the economy (not really, it’s to keep the entire system from imploding). This has not worked and could not work because we have a solvency problem that only gets worse as more debt is piled on the stack. They have succeeded in keeping the system afloat …so far but the real economy is sputtering. Digressing a little, if this were a “liquidity” problem, the current policies would have worked. They would have gained traction in mid 2009 and would now only be a bad memory, instead, we are living in an economic nightmare with hammers being used to perform brain surgery.

The goal is and has been to get people to “spend” their money, this we are assured will fix everything. Lowering rates and now pushing them negative are being used to force savers out of deposits and into “stuff” and or riskier investments. The velocity (turn over) of money is now at all time lows, it is thought that higher velocity is needed to get the economy growing again but there is a major flaw in this thinking which I will get to momentarily.

I would ask a couple of very simple questions. Since “economic man” does what he thinks best for himself, if currencies are depreciating and interest rates are negative, then why would he not just “save” in a different fashion? Why not buy old cars, antiques, art, guns and ammo (with an extra bid on your side by the government)? Why not buy “lumps of coal” (or even coal mines) if you know the currency is depreciating and “lumps” will be worth more at a later date? This thinking of course also applies to gold and silver.

As for velocity, the central banks had better be careful of what they are hoping for. They want more velocity, they want more spending. The problem as I see it is that they will eventually get their wish. Yes, banking has changed and now they can fund themselves with basically free central bank credits rather than deposits. I would suggest that a society or civilization cannot exist if it does not “save” and this is exactly what official policy is and has been promoting. “Spend it, don’t save it”.

What will eventually happen is a “currency event” where everyone flees at once. People will decide to buy “stuff” rather than keep their money in the bank. The decision will be threefold with the currency depreciating, negative interest rates and banks having the risk of failure and actually failing. THIS will be your hyperinflation. The "money" has already been created and put into the system which will fuel the inflation. Once people understand their currency is a "hot potato" and something not to be "stuck with", then velocity will explode…this will be "called" hyperinflation even though the actual inflation (increases in credt and money supplies) have already occurred.

We are now just beginning to "feel" the inflation heat up as you go to the store each week and the increases are now almost weekly. We have 2 separate ways for a monetary event to kick off, either on Main St. or Wall St.. I suspect it will be Wall Street but, if rates go negative enough or the fear of future inflation were to spread, the average Joe might just go to his bank and decide to do something else with his savings. Of course there is a 3rd way that a hyperinflation could take hold, when the price of gold gets away from them. If for any (number) of reasons gold were to spike in price we could then see a related monetary event occur. A higher gold price will create demand on its own. Any failure to deliver (which is becoming a greater possibility each day) will create the ultimate bank run where "savers" turn into "spenders". When it is thought that gold or silver is unattainable, everyone will want it because they cannot have it. Swapping cash balances for metal will be something that the 10 or 12 year old back in the 1960's would be able to understand, it's exactly what the powers that be running the show want NO ONE to understand.

One last comment, hyperinflation is a very funny animal which can rear its head literally overnight.

What I see coming is a break in confidence. This is the only thing now necessary for a currency crisis to begin, the event will be called hyperinflation in the history books.

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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

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