

# The curse of QE continues

The crises that have rattled the financial architecture over the course of 2023 are the legacy of the mega money printing exercise known as quantitative easing (QE), launched in the wake of the 2007-08 global financial crisis. The flood of money into the banking sector and numerous asset bubbles inevitably led to inflation and to the current drastic effort to rein it in. In this era of deregulation, central banks have attempted this challenge with their hands tied behind their backs, and one lonely tool—interest rates.

The subsequent financial blowouts are exposing more than the threadbare balance sheets of banks; they are exposing the breakdown of the financial architecture itself, and the utter inadequacy of regulatory agencies which have been taken out of the orbits of government and put under the sway of powerful private banks.

The crisis is also exposing the so-called solutions devised after the 2008 crisis by the same people who caused it: supposedly genius on paper, they don't work in practice. The authors of those programs are not happy. The General Manager of the Bank for International Settlements (BIS) is upset that regulators won't stick to the book on BIS programs. Recent crises in the USA and Switzerland have seen authorities "depart from the expected approach", Agustin Carstens has stated.

Carstens, speaking at the high-level meeting on banking supervision on 19 October in Panama City, Panama, on the one hand praised the novel approaches of central bankers to dealing with the collapse of US banks and Credit Suisse in March. But he insisted that all jurisdictions signatory to BIS resolution regimes (a.k.a. "bail-in", namely the confiscation of the investments and deposits of private citizens to save the banks) must upgrade their regulatory frameworks to allow full bail-in procedures to be followed.

The gathering addressed by Carstens brought together the Association of Supervisors of Banks of the Americas, the Basel Committee on Banking Supervision and the BIS Financial Stability Institute. These are the agencies that police the banking regulators of 63 BIS member nations: 34 in Europe, 16 in Asia, five in South America, three in North America, three in Africa, and two in Oceania—including Australia.

In his speech, titled "Some lessons for crisis management from recent bank failures", Carstens reviewed the "mixed" performance of the US Federal Reserve and the Swiss National Bank in tackling the recent bank failures.

Both used elements of the resolution process, but in a hybrid approach.

In Switzerland, "the authorities opted to impose losses on some creditors without using the resolution framework", Carstens noted. Swiss authorities merged Credit Suisse with UBS using emergency powers, describing the merger as a "commercial transaction". They judged this path as being "less disruptive to financial stability", said Carstens. They "decided not to use statutory resolution powers to execute the resolution plan", however losses were imposed on creditors who held bail-in-able bonds. "This proved", said Carstens, "contrary to the fears of some observers, that a writedown of G-SIB [global systemically important banks] debt instruments is feasible without destabilising markets in any deep or persistent way". Carstens was responding to long-voiced claims that confiscation of private investments in banks, whether bonds or deposits (i.e. not only shares), would cause greater destabilisation to the banking system.

Carstens skited that following the resolution plan by the book "would have bailed in a wider set of liabilities" than the one tier of bonds taken from Credit Suisse investors.

When Signature Bank and Silicon Valley Bank failed in the USA, Carsten continued, "the Federal Deposit Insurance Corporation [FDIC] took both banks into receivership, created temporary bridge banks and eventually sold the banks in the market".

The US approach, he added, was only possible because a "systemic risk exception" was declared. This allowed the FDIC to protect all deposits, including those that were uninsured. But the US banks that collapsed were not "systemic banks", therefore not subject to resolution processes. Something Carstens wants to change.

Carstens concluded that while the "overall story is positive" because systemic disruption was avoided, "the authorities had to resort to emergency powers or exceptional actions". Therefore, he ruled, crisis management frameworks must be improved to sweep up everything. His disapproval of the actions of sovereign governments—using their discretion rather than following the plan—highlights the true intention of BIS crisis management: gaining control over the policies of nations across the globe.

## Finalise the regime

This experience is in keeping with the chequered history of European Union bail-ins, which have never been successfully implemented according to the plan because it simply doesn't work in the real world. ("When is a bail-in still a bailout?", AAS, 4 Mar. 2020.)

Performance of the national authorities was “mixed” because, while systemic stability was preserved, “both involved public support” for banks, noted Carstens.

Banks must increase their “loss-absorbing capacity”, he decreed, so this tool can be fully utilised in future crisis, *and*, to protect the “credibility of bail-in as a resolution tool”. Authorities, said Carstens, “need to be confident that they can execute a bail-in and *markets must believe that a preferred bail-in strategy is not just words on paper.*” (Emphasis added.) One of the fathers of bail-in, ex-Bank of England and BIS bigwig Sir Paul Tucker, has repeatedly challenged the credibility of bail-in, warning in 2022 that “until bail-in has worked in a massive live case, not just in desktop exercises”, back up options should be retained. (“Markets lose faith in ‘bail-in’: BoE bigwig”, AAS, 30 Sept. 2020.)

Increased loss-absorbing capacity must be a requirement for all banks, not only the globally systemic ones, said the BIS manager, a measure which has been adopted in the European Union, and which other nations are bringing forward. He mentioned that a consultation on this is underway in the USA. Also noted is the need for greater cross-border cooperation between regulatory authorities. The recent failures, said Carstens, provide impetus for finalisation of resolution frameworks at the international level.

## RBA: Caught in the same trap

US banks crashed because their books were heavily loaded with the products of the most recent phase of quantitative easing, from late 2019. The mass of bonds purchased by banks at low rates were worth less and less as rates rose and investors sold existing bonds in favour of purchasing newly issued bonds at higher, more lucrative rates.

Australia’s Reserve Bank has essentially been affected by same situation.

Rising interest rates, as the Australian Financial Review wrote on 19 October, “smashed the mark-to-market paper value of \$330 billion of federal and state government bonds the RBA bought in the pandemic to reduce government borrowing costs”.

Additionally, the RBA is losing money from the \$188 billion term funding facility (TFF) established during the COVID crisis. The Reserve Bank loaned that money to private banks at around 0.1 per cent (three-year fixed rates) but has recently been paying the same banks around 4 per cent for deposits they park at the RBA. Banks started repaying TFF loans earlier this year and will continue through mid-2024.

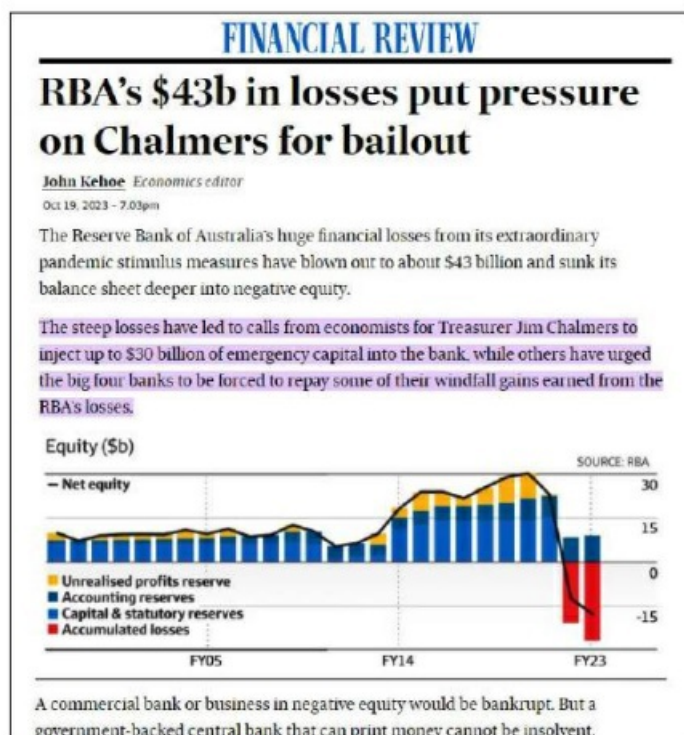
On 19 October the RBA revealed its losses, which now sit at \$43 billion, have forced the bank into negative equity to the value of \$17.7 billion (2022-23) and will reach \$27 billion by 2025. (See graphic.) The bank will work its way back into the black gradually by ceasing to pay its usual approximately \$2 billion annual dividend to the government for at least the next decade!

This situation has led to attacks on QE, proposals to claw back the money from the banks, and even to bail out the RBA.

According to the *AFR*, former Treasury official Peter Downes called for the Treasurer Jim Chalmers to step in to “recapitalise the bank”, a sentiment echoed by former RBA board member Warwick McKibbin, who commented, “Right now we’re running surprisingly large budget surpluses so why not inject it into the bank?” (Sure Mr McKibbin, but only if they are instructed to spend it on infrastructure!)

Another former RBA official, economist Zac Gross, called the losses the “hidden cost” of quantitative easing: “Quantitative easing involves buying bonds when yields are low and holding them until they are higher, effectively buying when prices are high and selling low—not traditionally the best way to make a profit.”

Proposing what is considered anathema to anyone in the political sphere, he suggested that “The RBA



The *AFR* coverage of RBA troubles. Photo: Screenshot

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could rein in these losses by reducing the interest rate they pay on excess reserves—effectively a tax on the big four banks and Macquarie.” Hear, hear!

*By Elisa Barwick, Australian Alert Service, 25 October 2023*

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