

When the going gets tough... bail-in or Glass-Steagall?



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With all signs showing global financial crisis 2.0 is coming down on us, moves to impose the “bail-in” of bank deposits are intensifying; on the other hand, there is also more discussion of the opposite approach to a financial crisis—Glass-Steagall banking separation.

In an extraordinary development, Australian banks have made changes to their deposit terms and conditions, effective 1 July. By any analysis, these changes are positioning the banks legally for bail-in. HSBC Australia has made the most explicit changes, which, according to a professional legal opinion (p. 3), have the effect of giving HSBC legal cover for the very actions taken in the 2013 Cyprus bail-in. HSBC is one of the biggest banks in the world, and operates in many jurisdictions that have depositor bail-in, which may be why its Australian subsidiary is so explicit.

Why are banks doing this now? For one reason—the wheels are falling off the Australian and global financial systems. Following on from the Reserve Bank of Australia’s panicked interest rate cuts, bank regulator APRA has dropped its mortgage serviceability benchmark interest rate of 7 per cent sooner than expected. Now banks only have to assess serviceability as 2.5 per cent above their mortgage rate, which could add up to barely 5 per cent. This will allow households on an income of \$100,000 to borrow \$60,000 more. Even establishment economist Stephen Koukoulas objected: “Financial stability has been thrown out the window”, he tweeted 5 July. “The credit fuse has been lit.”

Even more desperation came from the government. In an article entitled “Go easy on the banks, says Sukkar”, the *Australian Financial Review* reported on 4 July that Assistant Treasurer and Housing Minister Michael Sukkar was pressuring banks to loosen their lending standards. According to *AFR*, “Mr Sukkar signalled he agreed with the argument by banks that ASIC’s move to require more detailed borrower expense information would not be a reliable guide as to whether a borrower would default on a loan.” Essentially, Sukkar is insisting that banks return to trapping borrowers in debt they cannot repay, just to save the housing bubble.

The derivatives basket-case Deutsche Bank continues to be the greatest global financial threat. Following its plan to move US\$60 billion of its derivatives into a bad bank—a fraction of its nearly US\$50 trillion total derivatives—Deutsche Bank has announced the immediate end to its investment banking business, which was the cause of all of its trouble in the first place. This includes shutting its Australian operations (which were once managed by current Treasurer Josh Frydenberg and his Assistant Financial Services Minister, Senator for Bankers Jane Hume). Despite these moves its share prices continues to fall towards the US\$6.40 that is the threshold for a global meltdown.

Given these dangers, it is heartening to see more discussion of Glass-Steagall. Following Russian President Vladimir Putin’s attack on the policies of “liberalism”, the Russian Ambassador to London explained in the 3 July *Rossiyskaya Gazeta* that the issue is economic liberalism, which was used in the 1980s and 1990s to free business from social responsibility. “Simultaneously, there was a several-stage takedown of regulation of the financial sector under the Glass-Steagall law, which had been one of the key elements of F.D. Roosevelt’s New Deal”, Ambassador Yakovenko wrote. “It is lawful that the current crisis came about in 2008 in the banking sector, which had lost its connection with the real sector of the economy” (p. 8).

Prominent UK economist John Kay weighed in on the Deutsche Bank fiasco in a 9 July interview with *Frankfurter Rundschau*, by saying that none of the post-2008 GFC financial “reforms” solved any problems—an exclusive club of old men simply arranged things for themselves, and milked the taxpayers. The solution can only lie in a bank separation, like Glass-Steagall, to create banks that return to business in and with the real economy, Kay said.

In this issue:

- Legal opinion: Banks changing deposit T&Cs for bail-in
- Why has NZ suddenly guaranteed bank deposits?
- Resolving the RBA dilemma: Save the economy not banks!
- Murray-Darling Basin Plan was always a fraud
- Putin's 'end of liberal idea' bodes economic policy shift
- Is Trump stumbling into war with Iran?
- Subservient Australia used to stoke Cold War with China
- Morrison's Pacific step-up strategy aimed at China
- OPCW corruption vs Syria exposed
- Demand the bail-in law be amended!
- Demystifying economic relations with China
- ALMANAC: An unhealthy economy makes unhappy Americans

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