



The West with its back to the wall

Western politicians and media make people believe that the Ukraine war is the biggest problem in the world. This is not the case. Debt and inflation emerge as twin problems: The West has its back to the wall

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In one of my last posts on Western sanctions and the war in Ukraine, I wrote about the demise of the petro-dollar and mentioned that the West is broke - here is a brief analysis of this with a look back.

Since 1971, when the Americans refused to continue exchanging US dollars for gold, thus destroying the Bretton Woods system, countries have been free to print as much money as they want - paper money without any basis. This was obviously

too tempting and very soon led to strong inflation, which was most pronounced in the US.

In the 1970s, the uncontrolled inflation in the US made the US dollar so unpopular in the financial markets that in 1978 President Jimmy Carter was forced to issue bonds denominated not in US dollars but in German marks and Swiss francs. They were called Carter Bonds.

It was not until 1980 that Federal Reserve Chairman Paul Volcker, appointed in mid-1979, had the courage to really fight inflation. In 1980, he set the key interest rate at over 20 per cent in order to keep inflation down. This drastic cure worked and inflation in the USA was back to about 3 per cent in 1983.

Nevertheless - even after that, the states spent more money than they actually had, they simply printed it. What would get an ordinary citizen a few years in prison seems to be unproblematic for central banks: simply printing money when the money earned is not enough to pay the bills. Imagine having a credit card whose bills you never have to pay: throw the bill in the trash and keep shopping; the interest is carried forward to a new bill. A dream for every shopping queen - reality for every government.

1987, 2001 and 2008 were years of famous financial crises: Alan Greenspan, who was Fed chairman under four presidents between 1987 and 2006 (under Reagan, Bush Sr, Clinton, Bush Jr), invented the cure-all for financial market crises: The money floodgates were opened by lowering interest rates and, from 2008, so-called quantitative easing was introduced - an elegant term for money creation via the printing press.

The difference between the crises of 1987 and 2001 and 2008 was that the money floodgates remained open since 2008 and were never closed again. The interest rate remained at zero and the big central banks bought and are buying bonds and shares, simply everything that the normal market would not buy. This led the Western central banks to multiply the size of their balance sheets.

Since 2008, the balance sheets of the big central banks (USA, ECB, Japan, China) have increased from 7,000 billion to 31,000 billion US dollars. In other words, 24,000 billion dollars of money have been printed. On the special case of

Switzerland, see below. Since March 2009, the stock market index S&P 500 has already risen again after the crisis. All central bankers spoke of a strong economy, but did not raise interest rates and continued to print money - until today, almost fourteen years after the crisis.

When interest rates are virtually zero, it means that you can buy more with less of your own money. A simple example from the real estate market: If a well-situated family can spend 5,000 francs per month to finance a home, that is 60,000 francs per year. Twenty years ago, people in Switzerland paid about 5 per cent for a five-year mortgage. With that, said family could finance a house for 1.2 million francs ($60,000/5$ per cent). With a mortgage interest rate of 1 per cent, the same family with the same budget can finance a house of 6 million francs. So the property booms in the West have nothing to do with performance, but are merely inflated by free money.

Since 2008, the key interest rates in the West have practically not been raised. The central banks' justification was that inflation was still too low. This is, of course, nonsense. As the above example shows, the printed money did not leave the financial market, and thus price inflation simply did not take place in consumer goods, but in real estate, stocks and bonds, for example. This led to today's situation: never before in economic history have bonds, shares and real estate been so highly valued. All this at the expense of savers, who received no interest on their accounts or were even charged negative interest.

The large part of the population has no access to the financial markets at all, as they do not have the means to buy a house or invest heavily in shares. Thus, the richest 10 percent of the world benefited immensely from this situation and the rest of the population was left out in the cold.

From 2016 onwards, the US Federal Reserve raised the key interest rates a little again, but this led to a crisis in the so-called repo market as early as September 2019. The repo market is a market in which institutional investors can obtain short-term financing by depositing securities and simultaneously agreeing to buy them back - a repurchase agreement. However, this crisis was not even noticed by most market participants, as the Federal Reserve pumped huge amounts of money into the repo market to calm the situation.

However, this looming financial crisis was masked by Covid. Now central banks

had another good reason to set key interest rates back to zero, if they weren't there already, and open the money floodgates on an unprecedented scale. After losing 31 per cent of its value by 23 March 2021, the S&P 500 recovered to pre-Covid levels within six months.

Nevertheless, the monetary floodgates were not closed even after the Covid crisis, i.e. interest rates remained at zero and central banks continued to buy bonds and equities.

However, unlike the previous crises, which only resulted in the financial market getting money, during the Covid crisis trillions were distributed to the people, leading to a glut of money in the consumer goods market. Coupled with supply chain problems, the inflationary spirit finally found its way out of the bottle.

The special case of Switzerland, with its money printing, is a real tarnish and deserves a separate article. Unlike the USA and the EU, Switzerland did not spend more money than it took in - thanks to the debt brake. However, the Swiss National Bank (SNB) came up with the great idea of printing money to buy euros and US dollars. This was done to stop the strengthening of the Swiss franc, to protect the Swiss export industry.

Now Switzerland has the largest balance sheet in the world. Money was printed without necessity and used to buy the currencies of countries on the brink of bankruptcy. A strategy that was and is incomprehensible. Expressed in figures: the Swiss franc has a share of about 0.2 per cent of the world's reserve currencies - the US dollar about 59 per cent; that corresponds to a factor of almost 300. The SNB's balance sheet as of 31.12.2021 was about 1000 billion, that of the Fed 9000 billion. An unparalleled disproportion.

The SNB's equity capital amounted to about 20 per cent at the end of 2021. So if Switzerland's foreign currency reserves, which are held mainly in US dollars and euros, lose 20 per cent of their value, the SNB will be broke. In the first quarter of 2022, the loss on the currency positions amounted to CHF 36.8 billion. This loss is offset by a valuation gain on the gold holdings of CHF 4.2 billion. The overall result of minus CHF 32.8 billion drops equity from 20 to about 17 per cent. Dangerous tendencies.

The great injustice of inflation is that it hits the poor disproportionately harder than the rich. The rich do not feel it when their fillet becomes 20 per cent more expensive. For the middle class, who stand red-faced in front of the petrol pump, it is troublesome. But for the poorest, who already had their backs to the wall before inflation, it is a disaster. So it can be said that inflation is the most unfair tax because unlike, say, income tax, which demands more from the rich than the poor, the signs are reversed. I am surprised that the left does not give priority to fighting inflation.

Why don't central banks simply raise interest rates above inflation, knowing full well that this is the only effective way to fight inflation - as Volcker showed in 1980?

The reason is the debt: If the key interest rate is raised, the states will also have to pay more interest on their mountains of debt, which they cannot afford. Furthermore, the financial and real estate markets are so highly valued and pumped up with free money that a big interest rate hike will lead to a collapse.

What are the Western central banks doing? They conjure up a new world crisis - such as Covid or the Ukraine war - so that they have another reason to continue their game. The pitcher goes to the well until it breaks and that is where we are now soon.

Interest rates on 10-year government securities should be about 1 per cent higher than the inflation rate to get inflation under control. That would mean an interest rate of around 9 to 10 per cent for the USA and the euro zone, and around 3.5 per cent for Switzerland, if the official inflation figures are to be believed at all. These are regularly manipulated down by the states to look good and save money, for example on pensions and other things.

For the Swiss real estate market, an effective fight against inflation would thus lead to a base rate of 3.5 percent. That is 4.25 per cent more than today's -0.75 per cent. This would lead to a mortgage rate for 10-year mortgages of about 5 percent. What was normal twenty years ago would now lead to a real estate collapse in Switzerland.

So it seems that the West has its back to the wall financially - that's a nicer word than broke. I always assumed that a national government had to represent the interests of its own country. This principle should forbid imposing sanctions on third countries, which on the one hand do nothing and on the other hand plunge one's own country into the abyss. Unfortunately, the West does not seem to see the danger or does not want to see it.

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