

Fire hoses on “Max” at the Fed and the ECB: Do better times mean lower risks?

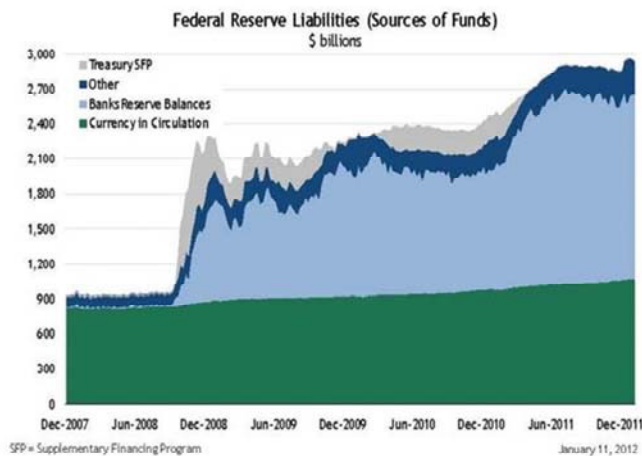
January 26, 2012

Why the bulls are out.

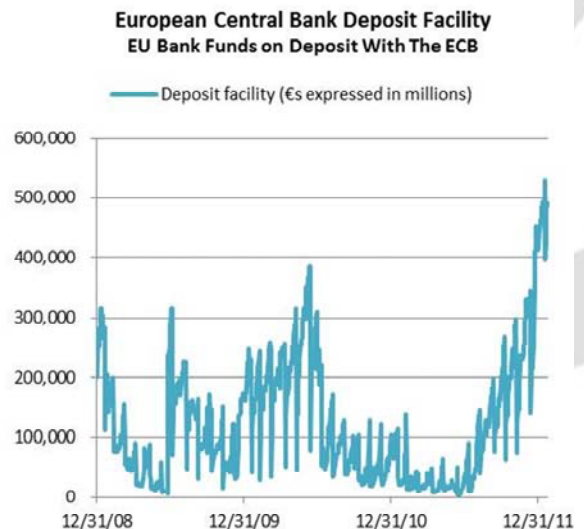
The bulls are out and for good reason.

Money is shooting out of the Fed and the ECB fire hoses at super-high pressure. The Fed upped the pressure with yesterday’s decision to leave interest rates at near-zero until the end of 2014 (past Ben Bernanke’s term expiry in January 2014) and its unequivocal QE commitment to buying assets whenever the economy needs an assist. The ECB expanded its money-output pressure with its €489 billion LTRO (Long-term Refinancing Operations) on December 21, 2011, with another slug upcoming in February.

Investors know money moves markets. They know they’re being pushed into high risk assets. They know others know. They’re hearing much more bullishness from officialdom in Europe and the US who want to build confidence and raise equity prices so that euro-banks can raise capital. They’re seeing many more bullish media commentators. They’re seeing stock prices rising. Their fear of a melt-up is rising.



Source: Federal Reserve Board



Source: ECB and Unio Capital

Risk is substantial.

Yet, if you look at the 2 charts above you see risk .

The sky blue section on the left chart shows US-based bank reserve balances at the Fed from 2008 to the present. They rose from close to zero in 2008 to about \$1.5 trillion today.

The turquoise line at the right shows Euro-based bank deposits at the ECB from 2009 to the present. They rose from close to zero in mid-2009 to €485 billion (or \$630 billion) a couple of days ago – essentially equivalent to the ECB’s €489 LTRO which flowed back into the ECB.

In both cases these are funds the banking systems of both geographies are **not** lending. They are **not** lending to the real economy. But they are also **not** lending to one another.

Bank-to-bank non-lending.

Banks not lending to banks is important.

One thing banks know a lot better than the greatest outside expert will ever know is the quality of **their**

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assets. And as we’ve seen, they often misestimate even that.

A second thing banks know better than any outsider ever will is the quality of their *competitors’* assets.

Banks not lending to banks says *we do not trust your balance sheets*. And then either they don’t lend. Or they lend on a fully-secured basis. *Fear of banks by banks* is the biggest message these charts are delivering.

Ben Bernanke knows this well. That’s why he looked so grim yesterday. That’s why he’s aiming the stream of his fire hose to the end of 2014 – whether you agree or disagree that this is the best or the worst way to lower risk.

‘Twas the most atypical of times...

Typically when better times arise, risks are receding.

Today we live on top of them like structures on the San Andreas fault.

All of which says these are times for the highly aware.

– John Allison

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