Professional Edition

Fed, US, And European Banking Data Update – Thursday, May 26, 2016 [1]

This is the last of a series of free Wall Street Examiner Pro Trader reports that I have been posting as I recover from my emergency open heart surgery on May 3. Next week I will return to regular publication of these reports for subscribers only.

This report covers US and European central banks and banking indicator trends and what they tell us about the outlook for the US stock and bond markets.

If you are a subscriber, these free reports are not charged to your subscriptions. I have now credited your account for the one month of downtime since these reports were regularly posted. This applies to all Pro Trader services.

I thank each one of you for your patience and support! Thanks to the many of you who have written to me directly offering your encouragement! I truly appreciate hearing from you. Fortunately, my recovery has been going very well.

If you are a new reader, enjoy! Click here for subscription information. *http://wallstreetexaminer.com/subscription-plans/ Try any of the services risk free for 90 days!*

Lee

[1] **Format notes** - Currently updated sections are in this font. Material that was updated recently and due to be updated weekly or monthly is in this brown font. Material in this font is infrequently updated background information for review or for the benefit of new subscribers. [1]

Table of Contents

This report looks at flows on the liability side of the balance sheet of the Fed along with secondary banking and financial indicators that can sometimes give us clues about the future. It is an adjunct to the Macroliquidity Report.

Virtually nothing has changed since the last update, other than an uptick in current US GDP for the second quarter. When economic data releases begin to reflect this next month, the market reaction should be negative as traders conclude, correctly, that the Fed will tighten. Markets top out when the news is good, because that is, in fact, when the Fed turns the screws.

Trends in the Fed balance sheet, in US commercial banking data, and in European banking data remain in place. The US banking system and systemic liquidity continue to expand as capital flows out of Europe, fleeing NIRP. Regardless of which central bank prints the money, capital will seek the highest returns relative to risk. With negative interest rates and negative sovereign yields in Europe, the US remains a magnet for funds fleeing the punitive policies in Europe. The flow of this flight capital into the US continues to buoy US stock and bond prices.

When that will end depends on both central bank policies and the faith and confidence of market participants in those policies. While we can track bank data for any sign of change in deposit growth or loan growth, the first signs are likely to show up in the technical analysis of the markets themselves, which you can follow in the Pro Trader market updates.

3/19/16 US bank loan and deposit growth continues to go bonkers at annual growth rates of more than 8% for loans and around 6% for money supply while loan and deposit growth in Europe are near zero.

Most of that loan growth has been in Commercial and Industrial Loans, which are not being used to finance business expansion. Instead, corporate executives are borrowing money to finance stock buybacks. They line their own pockets as they grant themselves stock options. Then they borrow money from the banks to cash themselves out while boosting the value of their stocks. No wonder the mafia envies Wall Street. It has managed to legalize the greatest heist in modern history.
In recent weeks I have repeatedly referred to the idea that the Fed is using the new QE—Quantitative Expropriation via NIRPitrage, to "encourage" capital to flee punitive negative interest rates in Europe and Japan. That capital enters the US via the purchases of Treasuries, which still have a positive yield. If that is the "plan", it is working brilliantly. US stocks are once again on a tear as US money supply balloons.

Meanwhile, one indicator to keep an eye on is the level of bank lending to finance securities holdings. That weekly data correlates directly with the prices of US Treasuries. It has pulled back in recent weeks and is threatening its f 52 week moving average. A trend break there, could signal a bear market in Treasuries, or at least a significant intermediate term rise in yields, which has already begun. Ironically, that would attract even more capital flows into the US.

3/2/16 Why does capital flow from Europe to the US as fast as Super Mario can print it? This is so simple, even a caveman would get it, but unfortunately, put 12 central bankers in a room and they lock the door to keep reality out. Capital flows to the US because Europe has negative interest rates (NIRP) and the US has positive interest rates. Big investors, speculators, businesses, and securities dealers all have the option of where to send and keep their money, and if Europe is stupid enough to tax them for keeping cash there, then by god, they'll just move it somewhere else. They'll move it to where it's safe, and where they can still earn a positive return, however, minuscule. That dear friends, means the good old US of A, land of the free and home of the half point, which, by the way will be heading higher soon.

As crazy as I think the Fed is, they are beacons of sanity in the delusional world of central bankers. Insanity is relative, and in this case, that relative dose of sanity is probably just enough for the Fed to recognize that positive rates in the US help to keep our Ponzi growing as long as Europe and Japan are negative. And if the Fed raises rates, those flows to the US will grow even more. It's not quite quantitative easing. It's really more of a quantitative expropriation. The ECB and the BoJ do the quantitative easing, then the Fed pays just a little more for it, and the cash comes flowing across the sea in massive waves. The result is a combination of NIRPitrage and Quantitative Expropriation.

1/13/16 Interbank Fed Funds lending continues to be virtually non-existent, down 90% from 2008 peak levels as the Fed continues to promote the myth that it has raised rates. Most banks are still so loaded with cash that they have zero need to enter the overnight funding markets.

The banks who are borrowing are the distressed exception. With all the excess cash in the system, those banks who need to borrow in the Fed Funds market are like households who borrow from payday lenders. They borrow because they have no other choice. This is hardly indicative of the market as a whole, where there is no bank borrowing.

In spite of the Fed's balance sheet being flat, bank loans are soaring. This excludes loans to finance securities, which have been flat. Isn't it strange that credit to business and individuals is soaring and GDP growth is slowing? Based on the latest official release, GDP growth is down to around 2% from 3% in 2014, and the real time tax data that we track suggests that real growth is now less than 1%.

According to economists, credit growth and economic growth go hand in hand. According to reality it doesn't, and in fact, too much credit apparently is associated with slow or no growth. As we know from our experience of a decade ago, extremely rapid credit growth leads to extremely rapid, and devastating, correction.

Unfortunately, bankers are always the last to learn that lesson and since there's been no moral rectification of the last credit bubble, we're having another one in rapid succession moral hazard at pillar of salt proportions.

This one is now on the doorstep of correction. Given that it has metastasized to a much greater degree than the last one, the end result is likely to be far more damaging, especially since the world's central banks have used up their monetary trickery and their credibility in bringing us to this point. Even if they tried to stop a collapse by printing more money, it's doubtful that enough players have enough faith in them to buy into the con one more time.

1/7/16 As for the really important stuff, I've started to notice that an uptick in money market assets has taken on an air of persistence and trending over the past year. This was before the Fed rate increase, so it was not in any way an attempt to capture higher returns. Instead it appears to be the beginning of a trend away from risk, something that we've seen hints of from other financial indicators. This is bad news for the long term outlook for stocks because if the investing public is becoming more risk averse, there is nothing that central banks can really do to inflate markets. They will be pushing on a string as the massive machinery of the worldwide leveraged speculating community with its trillions in assets moves toward deleveraging and unwinding their massive carry trades. It will not be pretty.

11/2/15 A flat Fed balance sheet is still tight money when the Treasury is issuing new supply. The Fed is not supplying much cash to help absorb that supply in doing just MBS replacement purchases of around $20-25 billion per month. As the dealers use their cash to absorb Treasuries, without funding from the Fed they normally need to liquidate some assets to free up cash to buy the new supply. That could be other Treasuries, in which case Treasury bond and note prices decline and yields rise. The second most likely place for the dealers to raise cash would be by selling stocks. I just think that that's a matter of time.

In a vacuum, these processes would already have become clearly visible this week. But we're not in a vacuum. The BoJ and ECB are still funding the participants in their monetary systems, who include most of the Fed's Primary Dealers. Some of that funding continues to flow straight into the US markets. That's why stock prices can continue to levitate in spite of Fed tightness. When and how that will change will depend on changes in ECB and BoJ monetary policy, which if anything, threaten to get looser.

Meanwhile the Fed is threatening to "raise rates" in December. That's not the same thing as a real tightening, as we have discussed in these pages for a long time. A "real tightening" would entail the Fed actually shrinking its balance sheet. The first thing it might do to achieve that would be to stop the MBS replacement purchases. That would remove the $20 billion or so in Fed funding of Primary Dealers and the Fed's balance sheet would shrink by that amount each month. As far as the Fed "raising rates," that's just hot air. I don't think that they could make a rate rise stick without removing some of the excess cash in the system.

Fed Assets (Weekly H.4.1)

The Fed's total assets fell this week as MBS paydowns outpaced the settlement of the Fed's purchases. That decline will be replaced next month when the Fed holds its next monthly MBS settlements, June 13-21. The size of the Fed's balance sheet remains flat, fluctuating within a narrow range each month.

Millions of dollars

Assets, liabilities, and capital	Eliminations from consolidation	Wednesday May 25, 2016	Change since Wednesday May 18, 2016	Change since Wednesday May 27, 2015
Assets				
Gold certificate account		11,037	0	0
Special drawing rights certificate account		5,200	0	0
Coin		1,837	- 21	+ 47
Securities, unamortized premiums and discounts, repurchase agreements, and loans		4,396,845	- 11,735	- 4,184
Securities held outright[1]		4,229,807	- 11,743	+ 10,839
U.S. Treasury securities		2,461,637	- 84	+ 998
Bills[2]		0	0	0
Notes and bonds, nominal[2]		2,342,092	- 200	- 4,551
Notes and bonds, inflation-indexed[2]		103,134	0	+ 4,600
Inflation compensation[3]		16,411	+ 116	+ 949
Federal agency debt securities[2]		25,096	0	- 10,799
Mortgage-backed securities[4]		1,743,074	- 11,659	+ 20,640
Unamortized premiums on securities held outright[5]		182,397	- 694	- 17,249
Unamortized discounts on securities held outright[5]		-16,089	+ 46	+ 1,592
Repurchase agreements[6]		610	+ 610	+ 610
Loans		120	+ 46	+ 24
Net portfolio holdings of Maiden Lane LLC[7]		1,713	0	+ 16
Items in process of collection	(0)	144	- 35	+ 51
Bank premises		2,220	0	- 21
Central bank liquidity swaps[8]		1,006	0	+ 1,004
Foreign currency denominated assets[9]		20,667	- 177	+ 1,233
Other assets[10]		20,442	- 662	- 1,017
Total assets	(0)	4,461,111	- 12,630	- 2,870

Note: Components may not sum to totals because of rounding. Footnotes appear at the end of the table.

Fed Liabilities (aka "Money")

Assets, liabilities, and capital	Eliminations from consolidation	Wednesday May 25, 2016	Change since Wednesday May 18, 2016	Change since Wednesday May 27, 2015
Liabilities				
Federal Reserve notes, net of F.R. Bank holdings		1,408,488	+ 1,905	+ 83,609
Reverse repurchase agreements[11]		311,723	- 1,148	+ 33,086
Deposits	(0)	2,694,437	- 12,791	- 100,087
Term deposits held by depository institutions		66,820	+ 66,820	- 13,099
Other deposits held by depository institutions		2,339,987	- 59,642	- 196,933
U.S. Treasury, General Account		257,092	- 20,197	+ 93,511
Foreign official		5,179	- 24	- 53
Other[12]	(0)	25,359	+ 252	+ 16,487
Deferred availability cash items	(0)	275	- 116	- 571
Other liabilities and accrued dividends[13]		6,095	- 506	- 764
Total liabilities	(0)	4,421,018	- 12,655	+ 15,272
Capital accounts				
Capital paid in		30,094	+ 26	+ 976
Surplus		10,000	0	- 19,118
Other capital accounts		0	0	0
Total capital		40,094	+ 26	- 18,142

Note: Components may not sum to totals because of rounding.

The US Treasury withdrew $20.2 billion from its account at the Fed this week as it began to spend the proceeds of the annual April 15 tax windfall. The spending was greater than the Treasury's revenues and receipts from debt sales for the week. This is a typical seasonal drawdown, leaving the Treasury's cash balance still at a record for this date.

Regular bank reserve deposits, called "Other deposits held by depository institutions" fell $59.6 billion, entirely due to the Fed issuing a 7 day term deposit facility that took in $66.8 billion. This is just moving spaghetti around on the plate, exchanging one Fed short term liability for another. The Fed likes to pretend that the Term Deposits aren't money, but they are fully accessible with nominal penalties. To the banks that hold these deposits, there's no difference between them and regular reserve deposits, other than that they bear a slightly higher interest rate.

The Other deposits line, which includes Primary Dealers as well as Fannie and Freddie, was little changed. Relative to the days of QE when we could see the flow of the Fed's payments into these accounts as it bought assets from the dealers, and then from these accounts to reserve accounts as the dealers traded and disbursed funds into the banking system, today the item is far less interesting and important. There's little useful information here.

9/23/15 The MBS settlements have been diminishing in size to the point that the cash often can be moved in and out of these accounts within the space of a statement week, so that we would not see the flows. When QE was under way, the monthly MBS settlements were so large that it took longer to move the funds and we were able to clearly see the flows into and out of this line item week to week. The shrinkage in these flows may not yet be to a point where they are now immaterial to the market, but they are certainly approaching that as the MBS replacement purchases trend lower.

RRPs were little changed. Of the $312 billion outstanding, $245 billion is with foreign governments and foreign official organizations which are flush with cash as the ECB and BoJ print it hand over fist. They lend some of it to the Fed.

How Cash Goes From The Fed to Primary Dealers to Reserves - Mid month deposits of the Fed's MBS purchase settlement proceeds to Other deposit accounts take a few weeks to be disbursed in trades or other transactions with counterparty banks, which results in several weeks of withdrawals from Other deposits as the funds are deposited to bank reserve deposits (Deposits held by depositary institutions). The money initially is credited to the Primary Dealer accounts when the purchase settles. The dealers then counteract business with counterparties or transfer the funds into their affiliated banks. That's how the money moves from Other deposits to bank reserves, aka "Other deposits held by depositary institutions" on the statement above.

From watching these flows on a weekly basis, we have been able to deduce that "Other" deposits include the accounts of the Primary Dealers at the Fed, along with what the Fed says are accounts of GSEs and foreign official organizations. The proceeds of the Fed's MBS purchase settlements show up in the Other deposits (Primary Dealer) usually the day of or the day after the settlements are completed.

Notes on Reverse Repo Program - 2/4/14 It is an outrage that the Fed pays any interest at all on these funds. It's money that goes back to the banks and dealers, on funds which the Fed printed and gave them, rather than to the US Treasury as part of the Fed's regular operating profits. Ultimately the interest the Fed pays the banks comes out of the pockets of US taxpayers. The same is true of bank reserve deposits at the Fed. The RRPs merely extend the universe of counterparties to whom the Fed pays interest.

11/3/14 The extra interest payments on these term deposits will reduce banks cost of funds and reduce the Fed's income, thereby reducing the amounts it returns to the US Treasury. In effect, taxpayers are funding these direct subsidies to the banks.

12/2/14 While these operations have technically moved these funds from being classified as "excess reserves," the practical impact is nil. The banks still have short term access to the cash, which they obviously have no use for anyway. The Fed has now also specifically stated that these funds can be used as collateral for short term loans to other banks. This effectively renders them same as cash for all practical purposes. The rate increase has had virtually no impact on the money markets.

2/18/15 Taxpayers pay the interest to the banks because anything the Fed pays out in interest reduces the surplus that it returns to the Treasury. I've ranted about this in the past in videos and posts on the free side of the site.

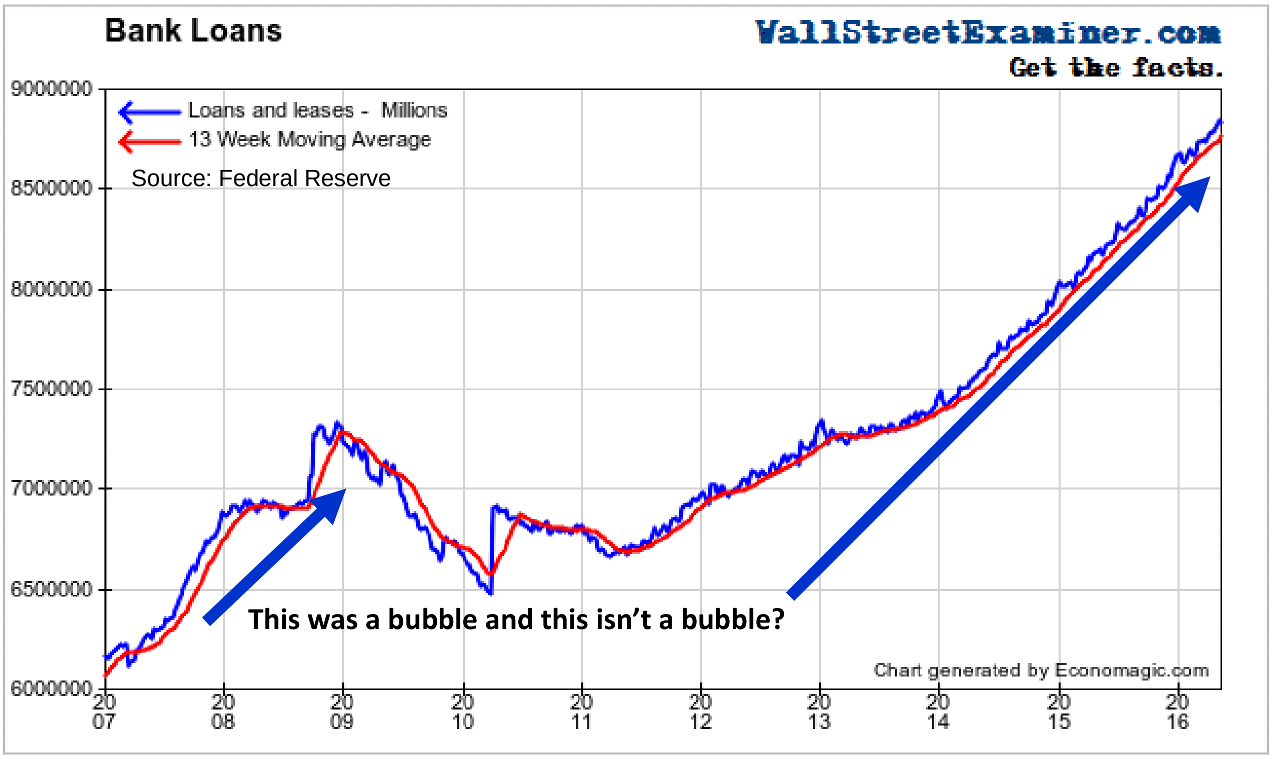
4/14/15 RRPs are Fed short term liabilities just like deposits, although the Fed's nomenclature doesn't recognize RRPs as reserves whereas with deposits, it does. When money is transferred from a deposit account to RRPs they temporarily cease to be categorized as reserves. When they move back to regular deposits, Voila! They're reserves again.

8/5/15 The Fed's thinking that increasing the size of reverse repo accounts will cause rates to rise is nuts. If the Fed increases the size of the RRP offerings and raises the interest rate it pays on them, this will lower the banks' cost of funds. That is supposed to cause them to raise rates?

Bank Loans Outstanding

Bank loans rose to another new all time record in the week ended April 13. The growth rate is now 8.1% which is up from 7.5% a week ago. 1/13/16 How can the economy be slowing with credit growth accelerating? Somebody should ask the Fed that. Don't count on bankers to know when they should be cutting back on lending. They are not the smart money. And they have learned that if they make too many loans, especially too many bad loans, their partner, the Fed will take care of that, no problem.

9/8/15 Deleveraging and writeoffs come after collapse, not before. Don't expect an early warning signal from loan growth. Banks will continue to lend and borrowers will borrow, well beyond the point of no return.



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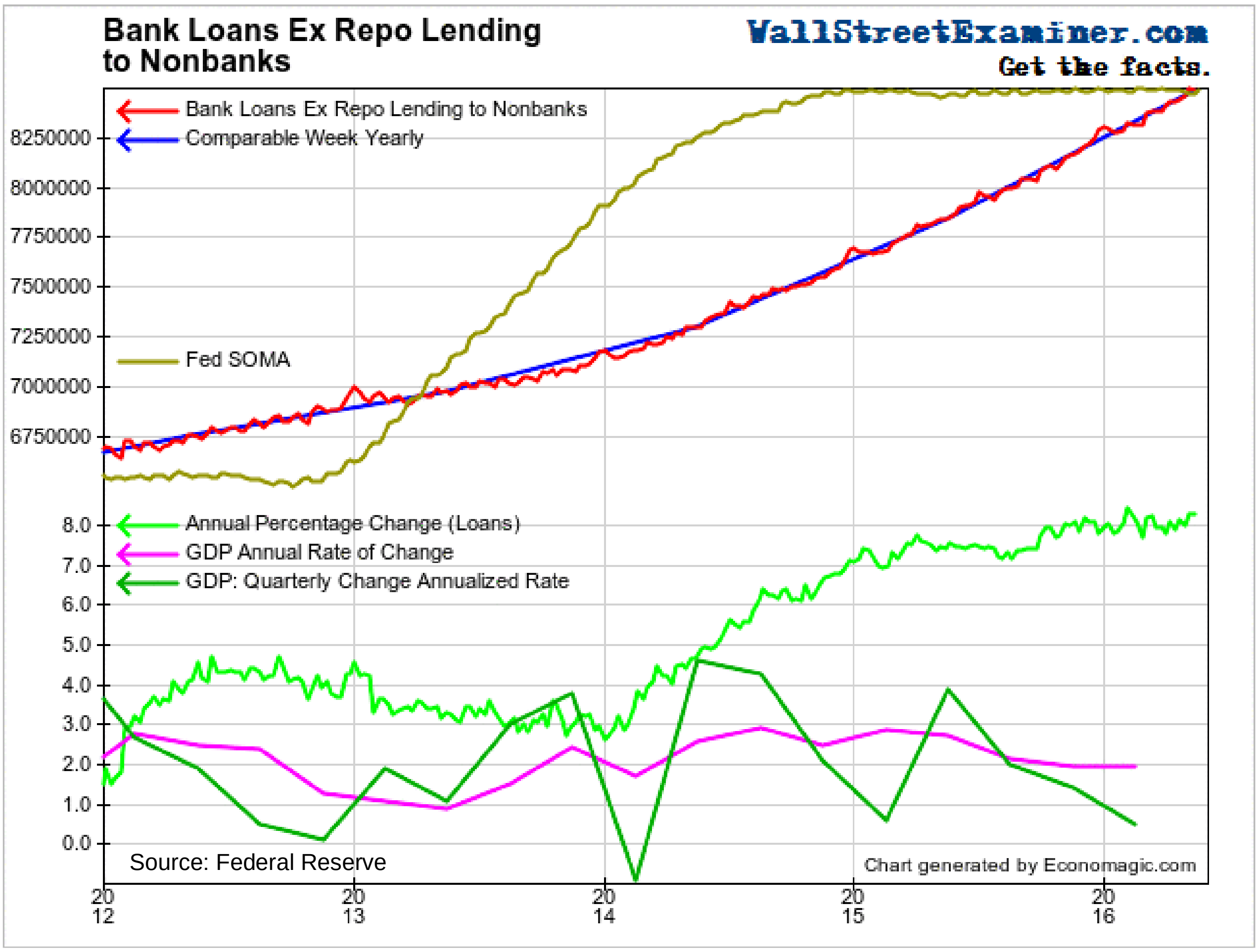
Lending not related to financing securities holdings continues to soar. The growth rate of loans excluding repo and other loans on securities collateral was +8.3% which is up from 7.9% a month ago and is just off the record growth rate of +9% for this phase of the credit bubble, set in December. There's no evidence of deleveraging. The credit bubble has actually heated up since July 2015. The economy slowed over the same period.

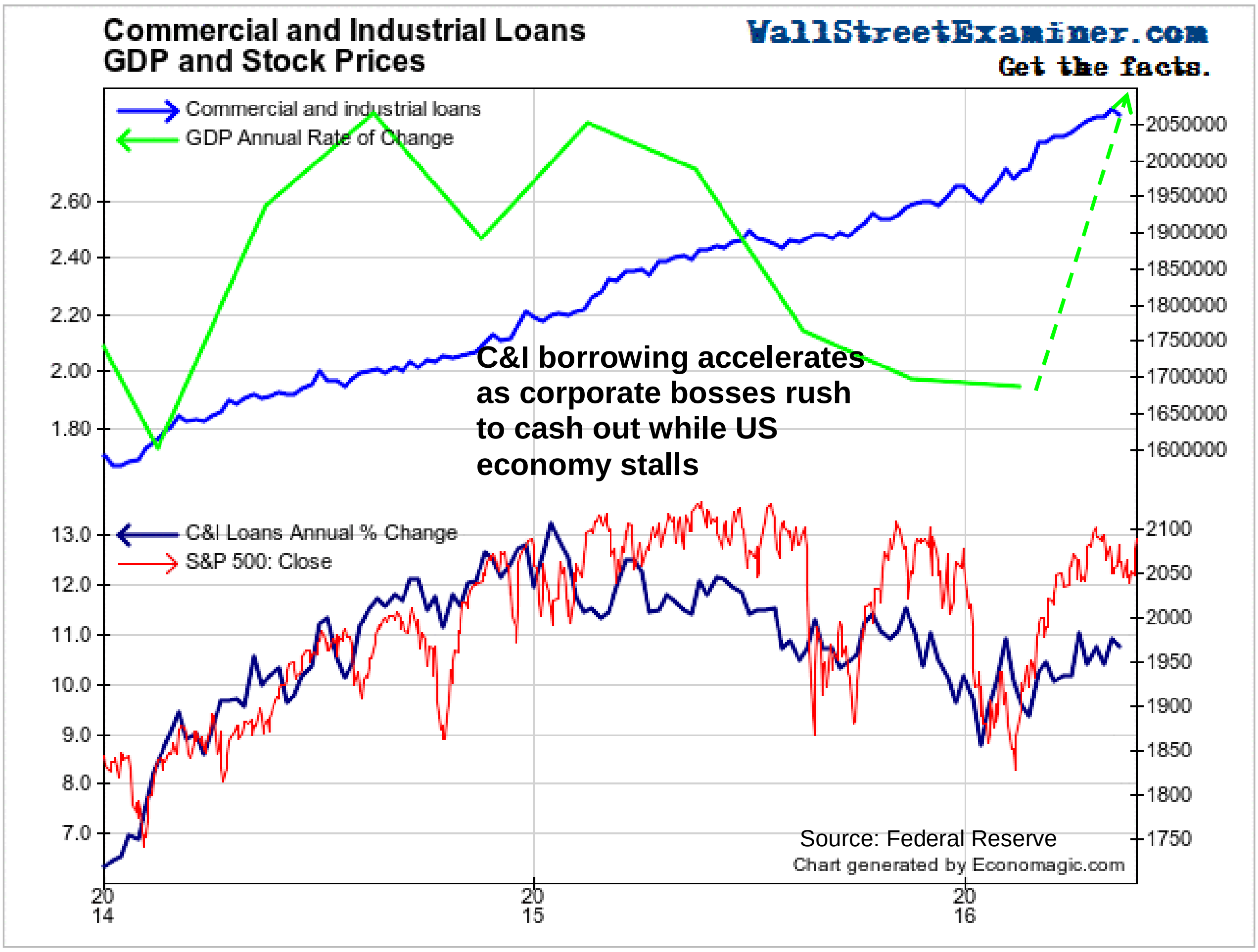


1/13/16 The stupidity of the BEA's 3 times revised, quarterly, seasonally adjusted GDP guesses can readily be seen on this chart. The annual growth rate has moved relatively smoothly, peaking near +3% in Q3 2014, and slowly decelerating to near 2% in 2015. The wild swings reported every 3 months never happened. It's total BS. We have had a very good handle on where the final GDP estimates would be from the real time tax data.

8/22/15 Bankers are counting on a growing economy to keep the loans they have issued for the past few years from going sour. A growing bubble can hide a multitude of sins. Once that growth stops, those sins are uncovered in the form of non performing loans and they can wreak havoc.

2/18/15 These are non-financial loans to businesses and individuals. The recent parabolic rise suggests a bubble that may be blowing off. However, the increase in bank lending has not seen a corresponding uptick in US economic growth based on the GDP data. The annual growth rate in GDP was actually higher a year ago when loan growth was less than half of today's growth rate. So much for the theory that tight credit was holding back growth. Like most economic theories, there's no support for it.

3/19/16 So what's going on with that? How can loans be rising so fast and the US economy slowing toward stall speed? Look what's happening with Commercial and Industrial Loans. They are soaring at an 11% rate. But that money is not going toward investment in the expansion of business. Too much of it is being used for financial engineering, as corporate executives use the funds to buy back their stock options, thus lining their own pockets while artificially boosting stock prices. This will ultimately end badly, but the question is whether it will be successful in extending the current regeneration of the bubble in equities by another year or two. That's an issue for technical analysis to address.

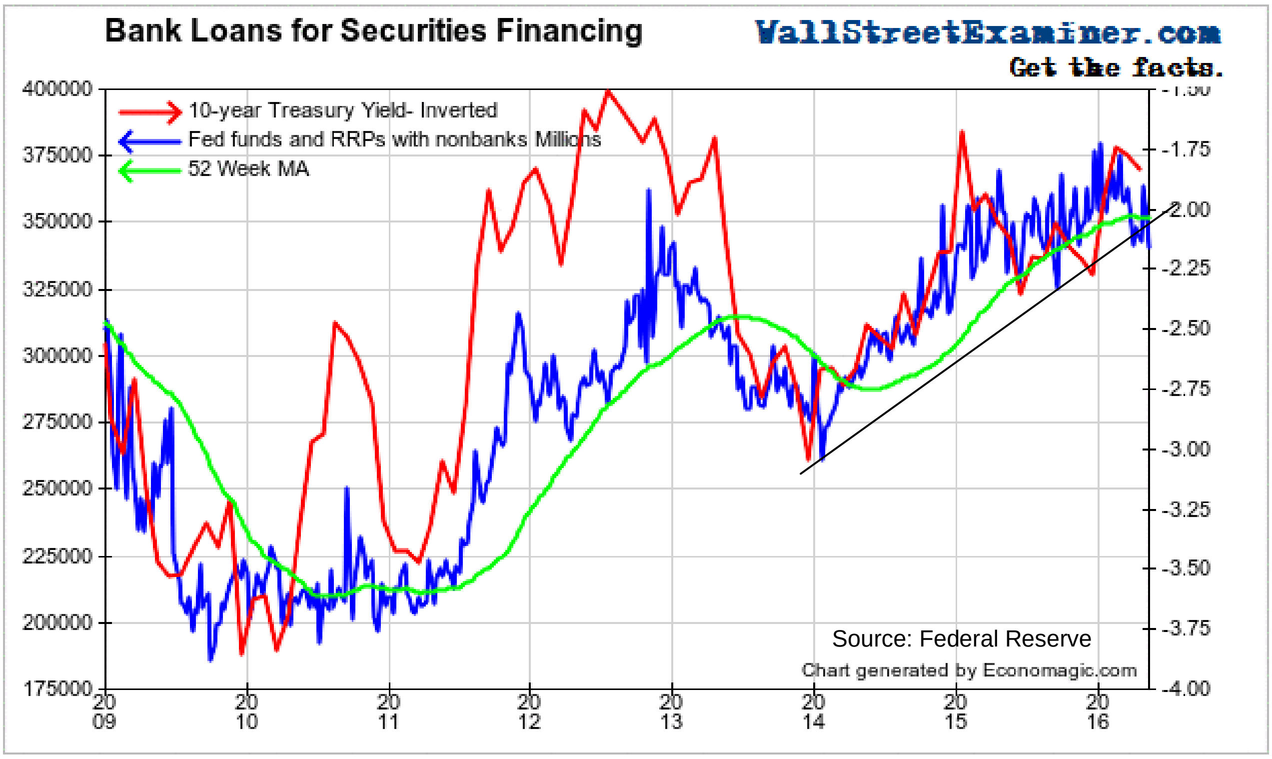


Note that second quarter projected GDP growth has upticked. This is supported not only by the Atlanta Fed GDP Now model but by our own tracking of the real time Federal Withholding Tax data as reported in the Pro Trader Federal Revenues updates.

Accelerating growth is bearish. It will encourage the Fed to tighten and will spook the stock market as traders anticipate that tightening. Lagging data releases have not yet fully reflected this recent strengthening, but they should do so in June for the May economic data. Markets top out when the economic news is good, not when it's weak, because the Fed tightens when the news is good.

Repo loans to nonbanks to finance carry trades and other securities holdings correlate almost perfectly with the prices of Treasury notes. Those loans have been rangebound for most of the past 15 months except for a brief spurt to new highs at the end of 2015. They have edged below the 52 week moving average and the uptrend line in place for the past 2 years. Further declines from here would suggest that the top in bond prices and low in yields has finally arrived. Stronger economic data could trigger that.

3/19/16 The pattern has been bullish for the Treasury carry trade since the September low last year, and going back to the reversal in early 2014. If and when this uptrend breaks it will be a bearish signal for both bonds and stocks, particularly so given the fragility of the financial system.



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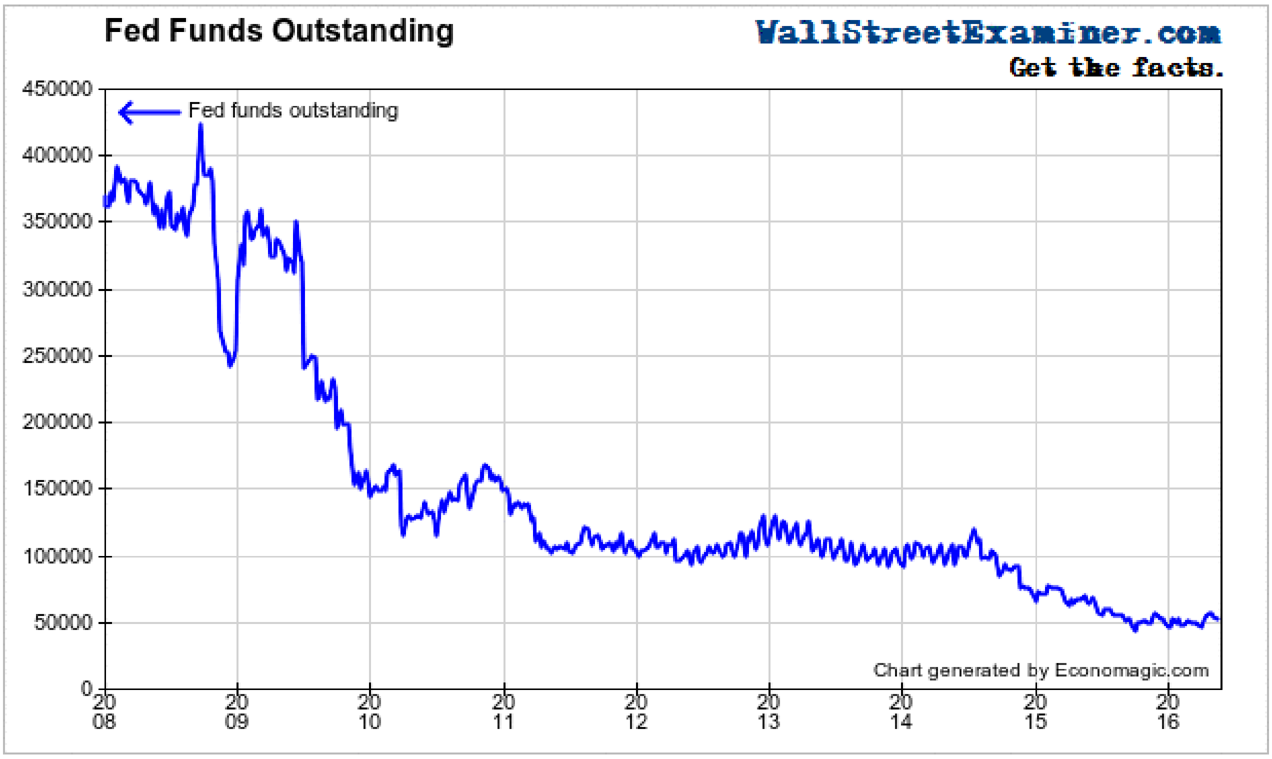
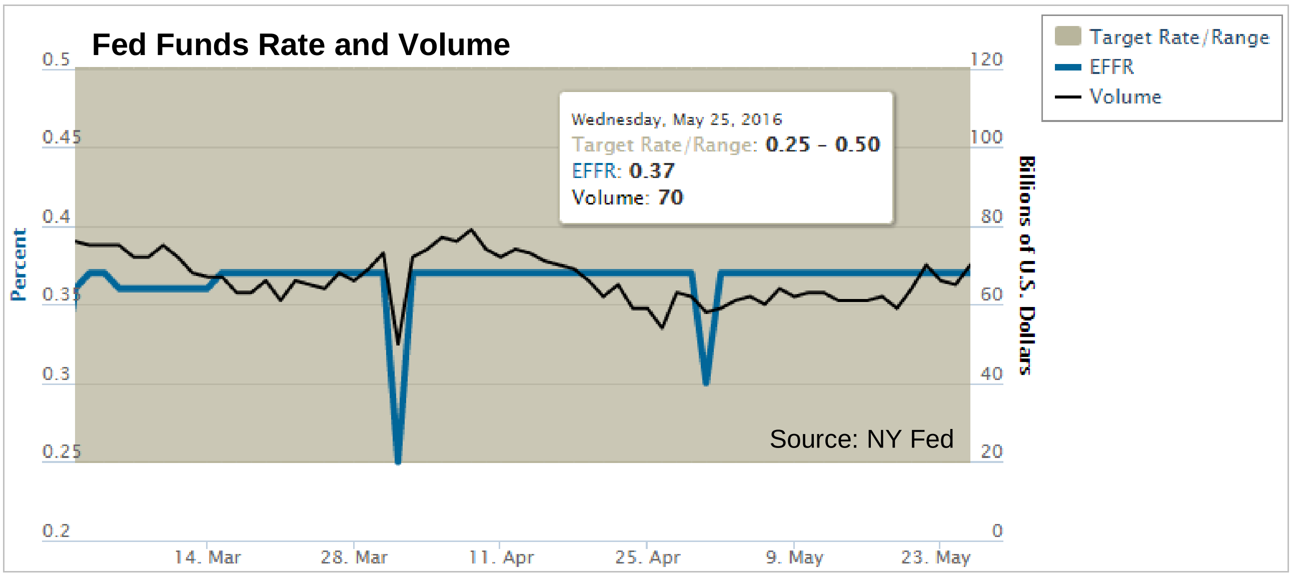


The Fed began publishing Fed Funds trading volume in March 2016. Since Fed Funds are overnight money, the amount outstanding at any point in time would be equivalent to the amount traded that day. So we already had a pretty good idea of the magnitude of the collapse of this market. I had discussed earlier (shown below) why the Fed Funds rate is more indicative of a desperation payday loan rate than anything bearing any resemblance to a real market rate.



2/10/16 The interbank Fed Funds market is a mere shadow of what it once was. Interbank repo lending has been dead in the water near the lows since September, when they had fallen by 90% from the 2008 peak. This doesn't even qualify as a dead cat bounce. The Fed pretends to control the Fed Funds rate. It's a joke. There is no Fed Funds market.

1/13/16 While the Fed attempts to "control" the Fed Funds rate, it's important to note that very few banks are borrowing in the Fed Funds market at all, and the ones that are do not represent the banking system as a whole, which is still awash in cash. The Fed Funds rate is, in effect, the payday lenders' usury rate for those banks who are, in essence, living paycheck to paycheck.

The Fed Funds rate reported by the Fed gives the illusion that there's a market, but that's all it is, an illusion, based on borrowing by distressed borrowers. In recent years, the overnight and short term lending market was dominated by carry traders and other financial engineers padding their risk free profits. The smart money left that building last year as the Fed telegraphed that it intended to raise rates. Those actively borrowing today are doing so not because they want to, but because they have to. That's why I call the Fed Funds rate a payday lender rate for banks.

10/20/15 In a way, considering the $2.7 trillion of excess reserves in the banking system, it's remarkable that there are even any Fed Funds remaining outstanding. But they are disappearing fast, hitting just $42 billion at the end of September, which was down "only" 90% from their peak in 2008.

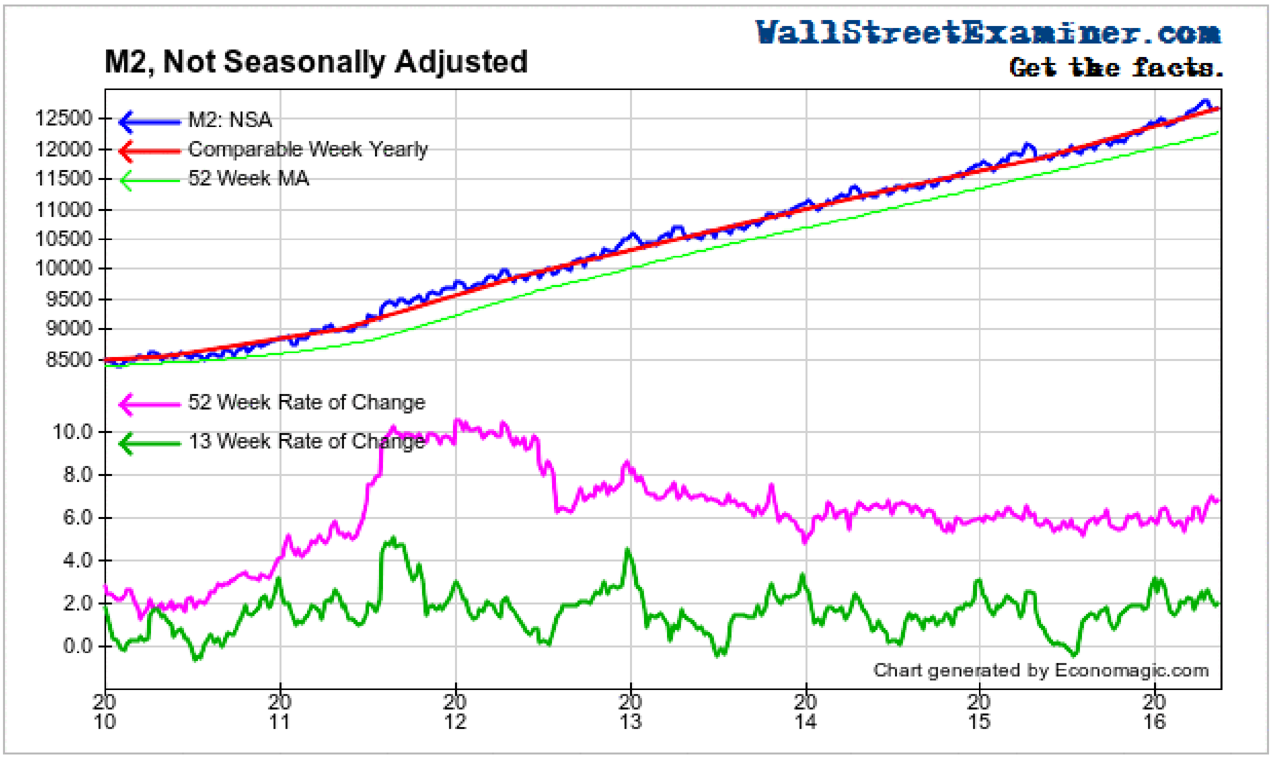
8/5/15 The crash in interbank repos in 2014 appeared to coincide with the expansion of the Fed's RRP operations. In 2008 the volume of interbank repos outstanding was typically $350-$400 billion, briefly exceeding that at the peak of the crisis. Since then they have steadily trended lower, to just $60 billion now. 12/2/14 Banks with $2.7 trillion in excess reserves do not need to borrow from each other. The Fed is also expanding its program of reverse repos, reducing the incentive of banks to lend to each other.

Fannie and Freddie

	Totals in Billions		
Apr-16	Fannie	Freddie	Total
Owned Portfolio	328.0	333.5	661.5
M/M Change	(4.6)	(6.4)	(11.0)
Y/Y Change	(143.4)	(108.7)	(252.1)
Ch. Since Peak	(489.8)	(471.9)	(961.7)
Total Book	3,100.6	1,953.5	5,054.1
M/M Change	(1.4)	(1.9)	(3.3)
Y/Y Change	(51.1)	45.4	(5.7)
Ch. Since Peak	(140.1)	(297.0)	(437.1)

GSE portfolios continue to shrink at a slow pace. Total declines since 2009 have been only a fraction of the amount by which the Fed expanded its portfolio. Even with the Fed out of the money printing business for the time being, the decline in these portfolios is too slow to have any impact on systemic liquidity, especially with bank loans soaring.

Money Supply and Money Fund Flows



Money supply declined in mid April as taxpayers sent checks from their bank accounts to the US Treasury. This is a regular seasonal event. The trend to new highs is only briefly interrupted each April. This year should be no different. NIRPitrage sends cash cascading out of Europe and into the US banking system via the purchase of US securities, usually Treasuries. Lately those flows have boosted stocks as some accounts rotate out of Treasuries.

Money supply growth has now accelerated to 6.9% per year after it had been trending higher at a 5.5%-6% annual growth pace. Loan growth and inflows from the rest of the world have continued to drive US banking system deposit growth, while deposit growth in Europe has been stalled due to negative interest rates (charts and discussion in last section of this report). Interest rate arbitrage has worked to the benefit of the US Last Ponzi Game Standing.

10/9/13 Money supply growth is still much greater than economic growth, which usually translates to asset bubbles in the current environment. Why not CPI inflation? Because the money is concentrated in the banking system in the upper income strata. The bulk of the population lacks spending power, which suppresses the rate of gain in consumer prices, while asset prices remain bubbly.

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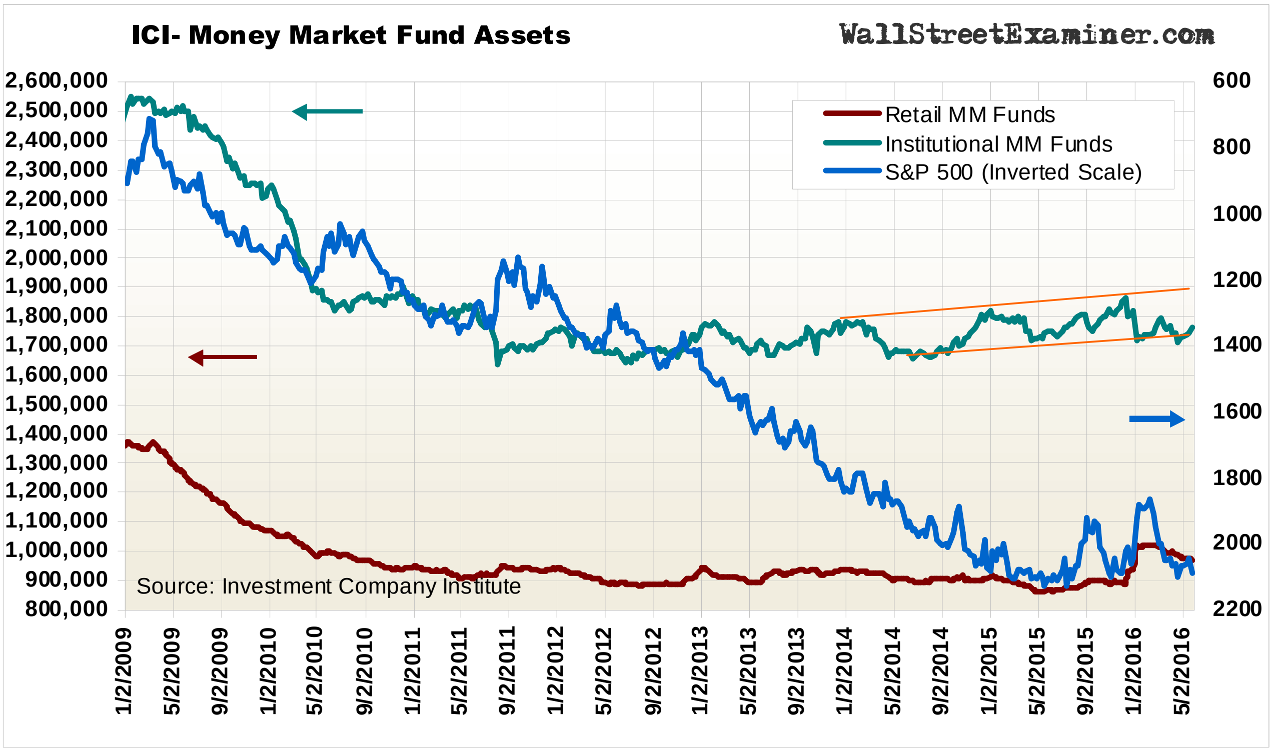
Money fund assets have been trending lower since stock prices started rising in February. That's a sign of increased speculative fever as investors pull money out of cash funds yielding nothing to buy stocks.

		Institutional				Retail		
		Total	Change	% Ch.		Total	Change	% Ch.
5/18/2016		1,744,730	4,620	0.27%		974,500	-330	-0.03%
5/25/2016		1,762,070	17,340	0.99%		971,360	-3,140	-0.32%
Since Peak		-30.88%	1/14/2009 peak			-29.03% 3/11/2009 peak		



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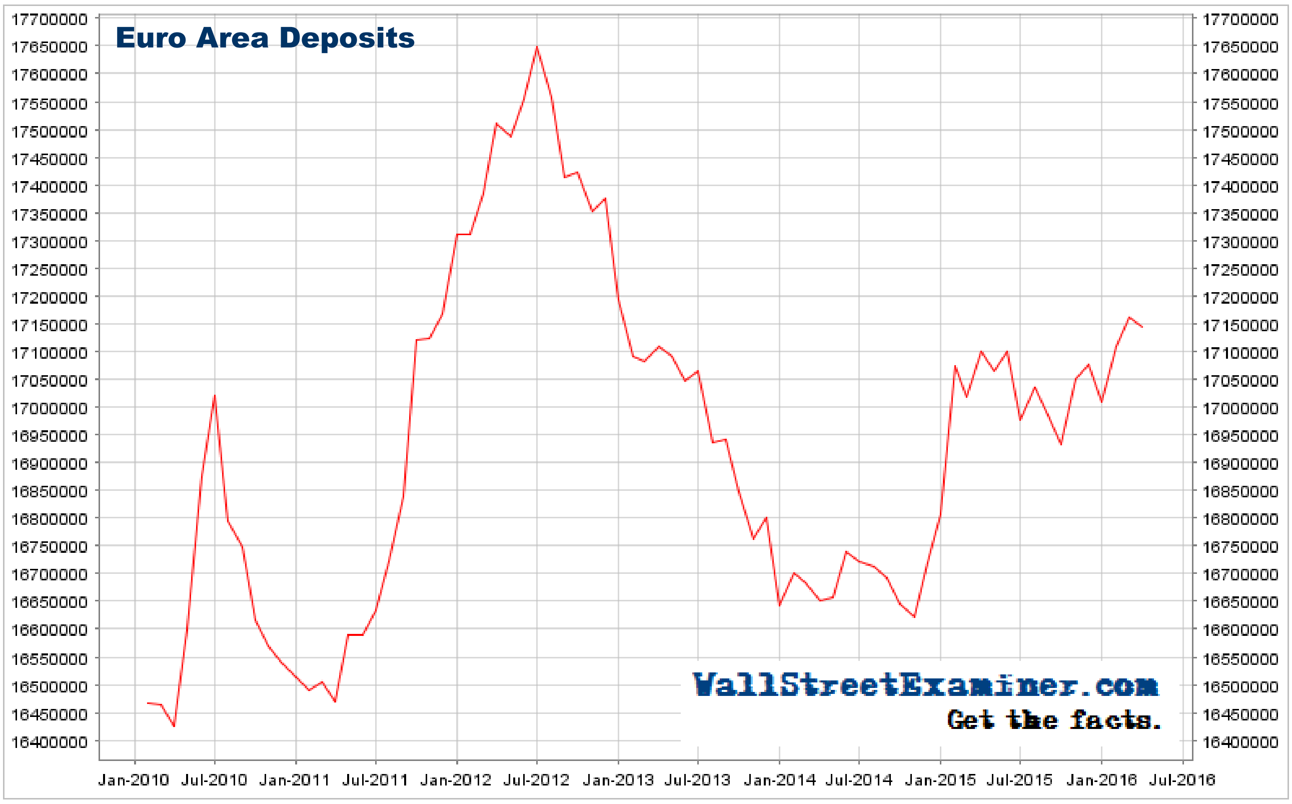
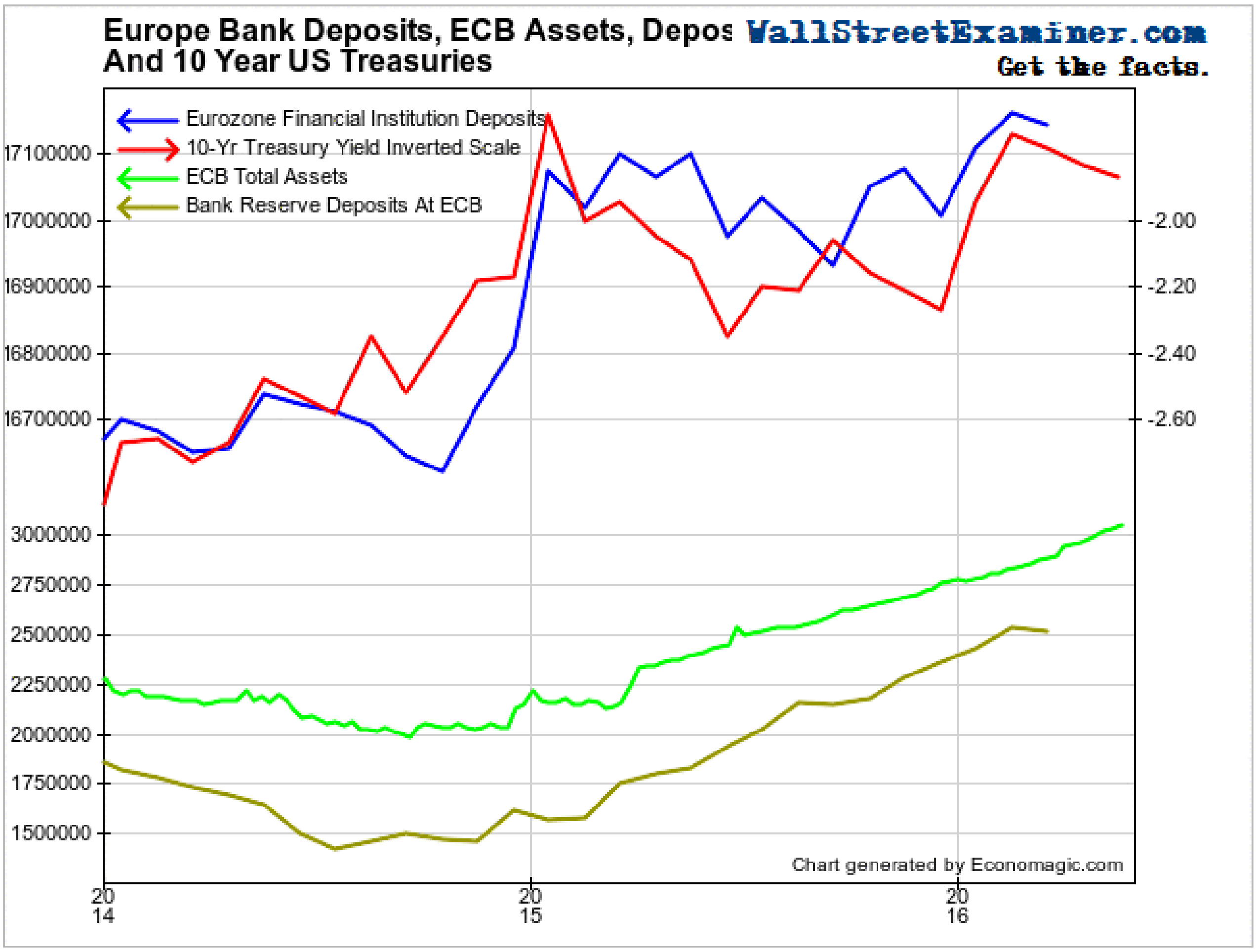
European Banking System Deposits and Loans

ECB data on bank deposits for the Eurozone shows total bank deposits pulling back slightly after breaking out in March. Money printing in the form of the ECB's asset purchases should cause a euro for euro increase in deposits, but that has not occurred. That's because a substantial portion of the ECB's newly printed money flees the Eurozone to avoid the NIRP tax. Considering that the ECB has printed and pumped about €1.1 trillion into the European banking system since 2014 and €600 billion since mid 2015 and that deposits have only increased by €150 billion sine mid 2015 , it's clear that capital flight to the US and elsewhere is draining deposits out of Europe.



3/2/16 Where's it going? I have constructed the chart below to illustrate what is happening. That chart shows the correlation between the ECB's asset growth, and the size of its various deposit facilities--what economists call reserves--along with the correlation to total European bank deposits and the direction of US Treasury bond prices.



Note the correlation between European bank deposits and the direction of US Treasury note prices (yield inverse) at the top of the chart. We obviously know that Some European deposit holders have been buying Treasuries. I have shown charts similar to this in the past which depict this correlation over the long term. This chart shows what has happened since the ECB started NIRP in June 2014.

The lower half of the chart shows that as the ECB purchases assets (green line) there is a like increase in bank reserve deposits at the ECB. This is basic Accounting 101. The ECB buys the bonds from the banks by crediting their deposit accounts at the ECB with money it materializes by waving its magic money wand through the electronic ether.

Those reserve deposits which didn't exist prior to that moment instantly become very real, and absolutely immutable. They can move around on the liability side of the ECB's balance sheet, but they can't leave it. Banks can get rid of their reserve deposits by buying assets from other banks, dealers, investors, businesses, or governments, but that only leaves another bank with the reserve deposit. Somebody will always be stuck paying the interest on the deposit. That makes those reserve deposits a hot potato that nobody wants, but nobody can escape as cash circulates through the banking system. Gone today, here tomorrow, oops.

The problem for the bagholding banks is that when they try to pass on the negative interest rates to customers, those customers with international connections do the rational thing, because, unlike central bankers, they are not insane. Deposit holders find the best option for their cash outside the European banking system, and the deposit leaves that system for greener pastures, most often in the US. Those deposits move frequently via the purchase of US Treasury securities or even US stocks. When the depositor buys Treasuries or US stocks, his bank exchanges his Euro deposit for US dollars and transfers the US dollars into the US account of the seller of the Treasuries. That could be a dealer, another investor, or the US government itself. The Euro deposits are thus converted to dollars and become US bank deposits.

This is basic interest rate arbitrage, and NIRP exacerbates that to the nth degree. That's how the ECB can pump 650 billion euros into the European banking system, and deposits in that system manage not to grow at all. Depositors aren't stupid. They're getting the hell out of Dodge. The only stupid ones are Mario Draghi and his fellow central banksters at the ECB and more recently the BoJ. This raving lunatic is singlehandedly keeping the US Ponzi Game markets rolling while doing absolutely nothing for Europe.

As insane US central bankers may be, I suspect that they are just lucid enough to understand the benefits of NIRPitrage to the US Ponzi. That's why I doubt that we will ever see NIRP in the US, and why the Fed may just follow through on its threat to gradually raise the sham Fed Funds rate (n0body really trades Fed Funds). The bigger the gap between positive rates in the US and negative rates in Europe becomes, the more capital will be encouraged to flee Europe and float US bond prices higher.

As we've seen recently, and as I previously forecast, it has also been enough to foment intermittent rallies in US stocks. This ridiculous pattern can go on for a long, long time. While buy and hold is dead, these policies result in tremendous trading opportunities on both long and short sides of the market for those who are paying attention.

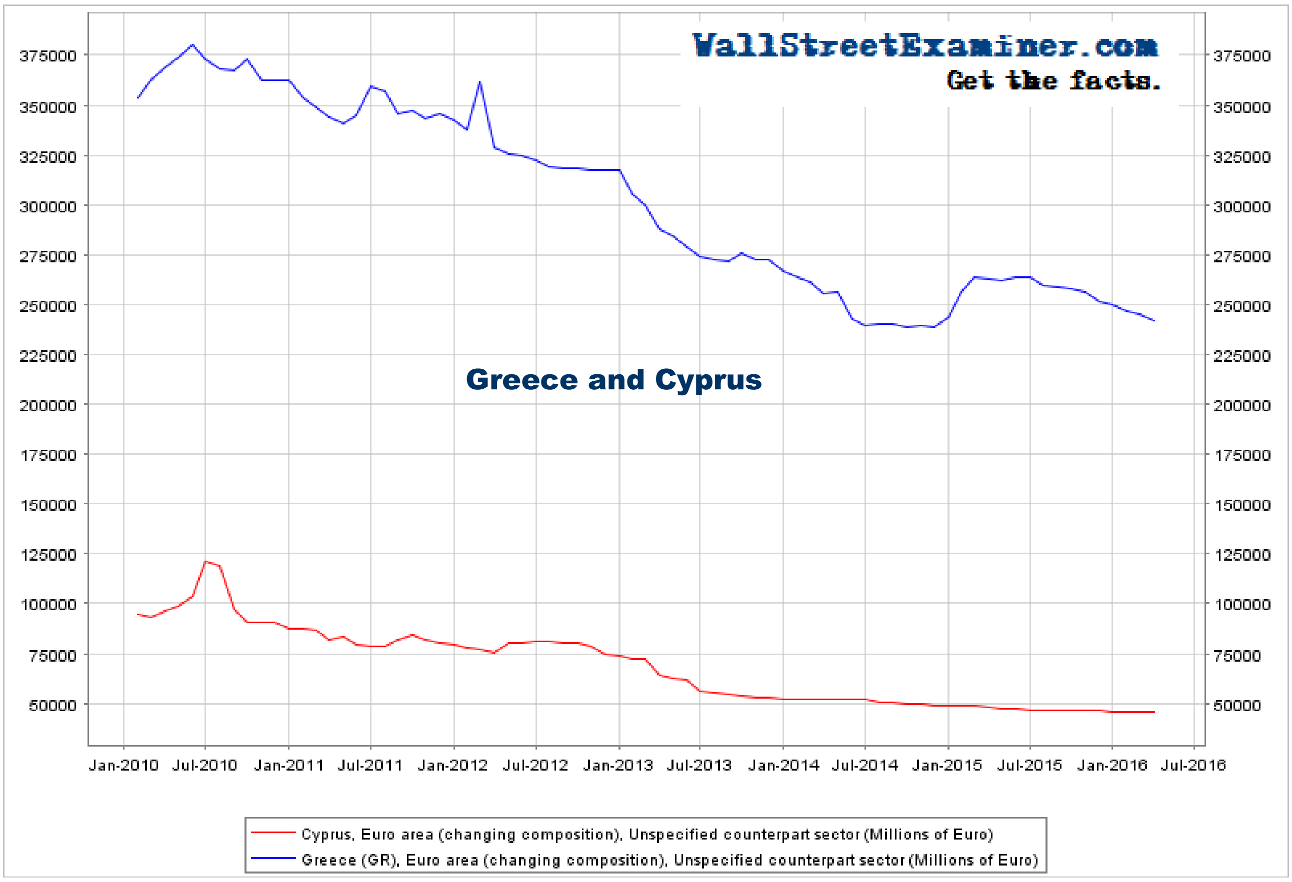
2/10/17 Negative interest rates have been a disaster, so what did the ECB do? It made them more negative in December. Central bankers are insane. The more negative interest rates become, the more contractionary they are.

10/27/15 Negative deposit rates cause falling deposits and banking system contraction, exactly the opposite effects of what the policymakers expect. This is exactly what common sense told us would happen when the negative rates were announced in 2014. Yet in spite of a year of proof, central bankers seem incapable of making the connection. The shrinkage of deposits is a sign that the funds are either flowing out of Europe or are being used to extinguish debt. In either case it would be a bad sign for the European economy and if it's the latter it would be bad news for world markets.

2/25/15 The weakening trend of 2013 was apparently largely due to the paydown of ECB emergency loans. That simultaneously extinguished deposits. Since the ECB instituted an interest charge on deposits held at the central bank, banks had been liquidating outstanding loans again in order to extinguish deposits.

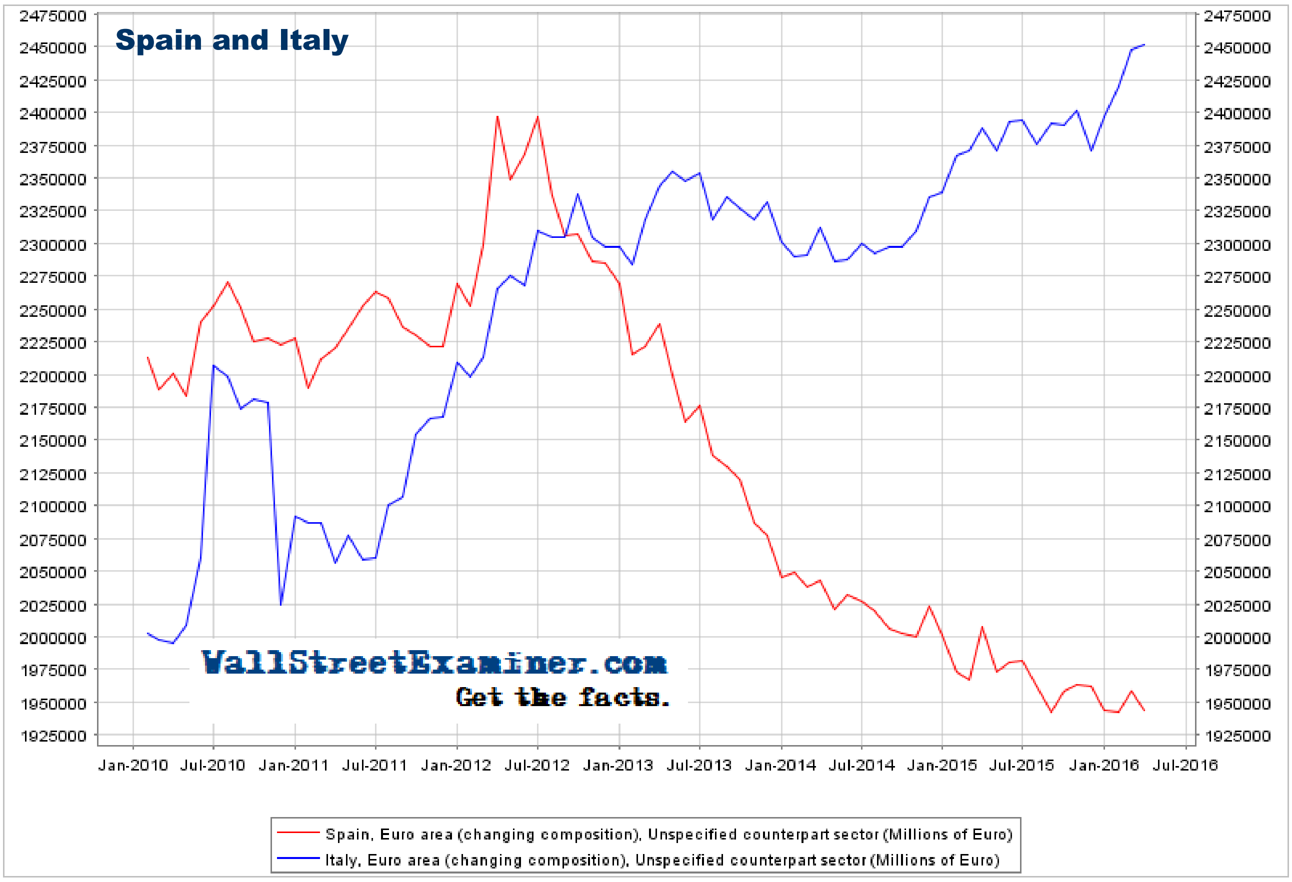
The decline in deposits since the institution of the negative central bank deposit rate was entirely predictable, but the ECB pundit community was foaming at the mouth in panic, determined to see the ECB institute outright government bond purchases. That finally happened.

Meanwhile, here's a little deeper look at European bank deposits and loan activity. Chart data as of April 30.



Deposits in Greek banks have been slipping for most of the past year. The increase in deposits early in 2015 was due to increased deposits of "Monetary Financial Institutions." Household and non-financial corporation deposits were crashing prior to a dead cat bounce in December and January.

Deposits in Italy have surged lately. Apparently Draghi is buying a lot of paper from Italian banks. Spain's deposits remain under pressure. Having been in Spain for the 6 weeks in Jan-March 2016, I think I know why. There are at least 3 bank ATMs on every block of every major city. The banks seem to encourage you to get your money out!



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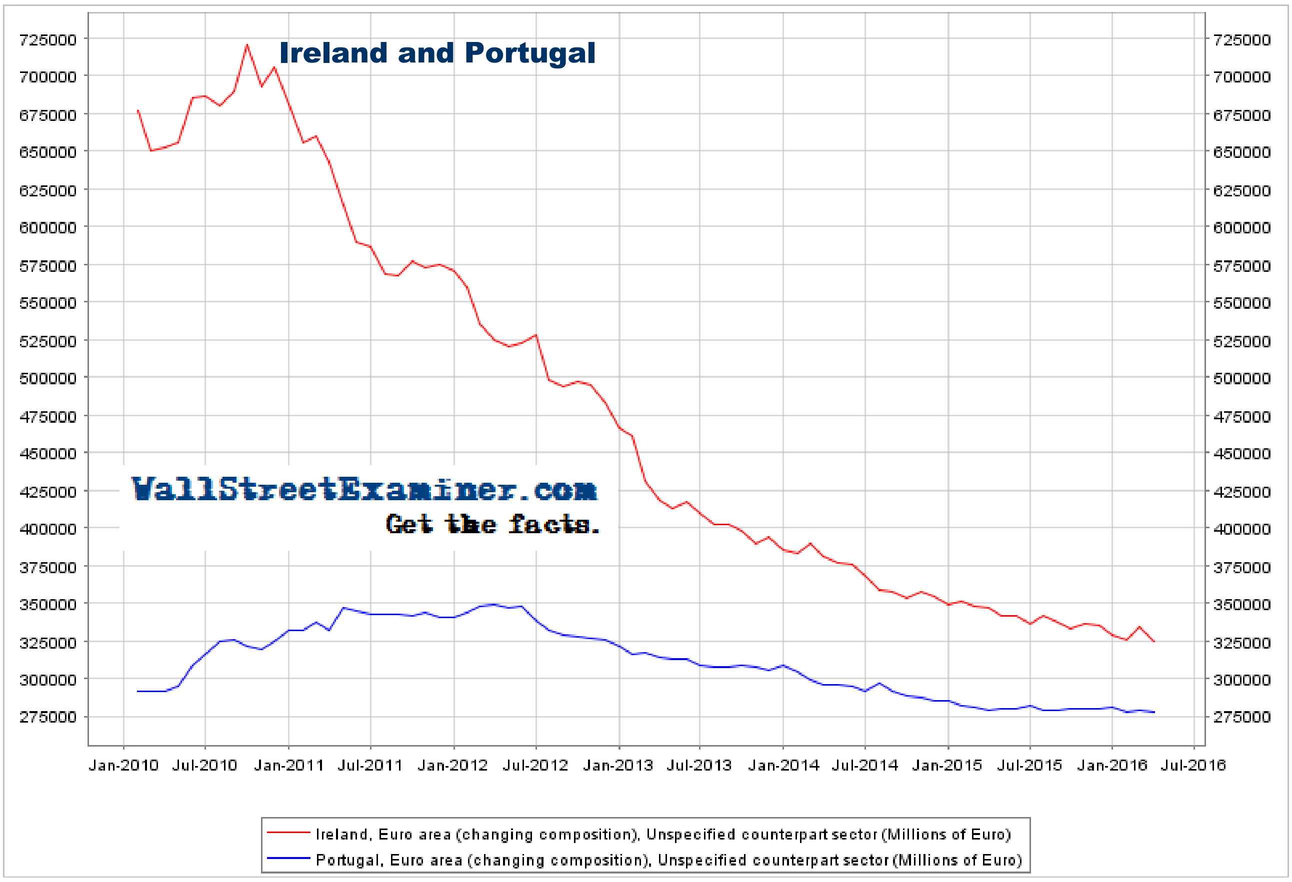

Deposits in troubled Ireland and Portugal continue to trend lower.

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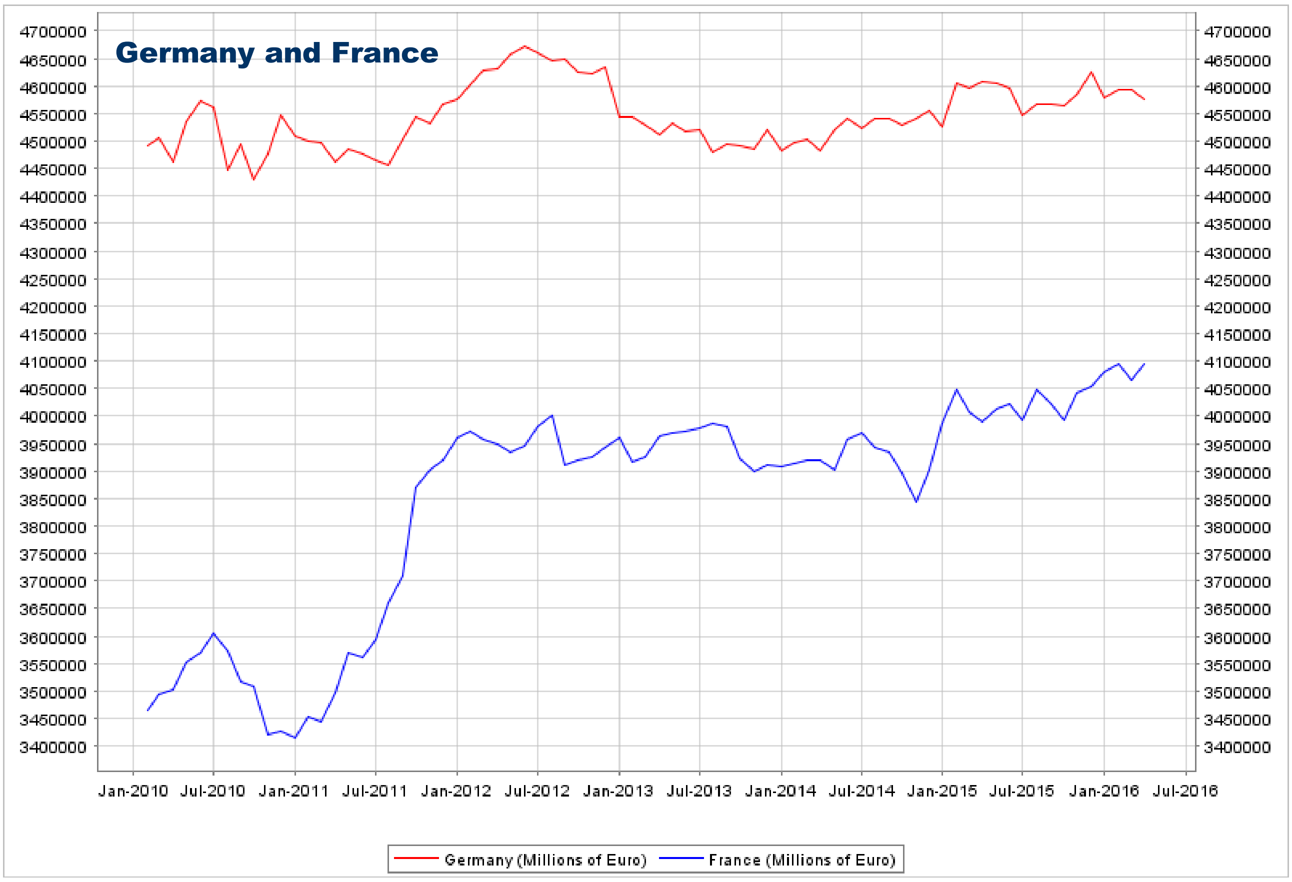

The ECBs money printing had caused minimal deposit growth in Germany and France but nowhere near the amounts that the ECB has pumped into the system, and German deposit growth has stalled since last December. While some of the ECB cash has flowed to US shores, perversely, much of it has been used to extinguish debt, and thus deposits.

Households have been growing deposits in Germany and in France. Non financial corporate deposits have been trending higher, moreso in France than Germany (Charts below). These increases were all an effect of negative rates. Deposit costs are lower than the cost of holding government paper. Businesses and wealthy families choose not to hold highly negative yielding government bonds. This will ultimately prove disastrous when the banks collapse and depositors are forced to bear the losses. Deutsche Bank's recent troubles are just the tip of the iceberg, the first domino.

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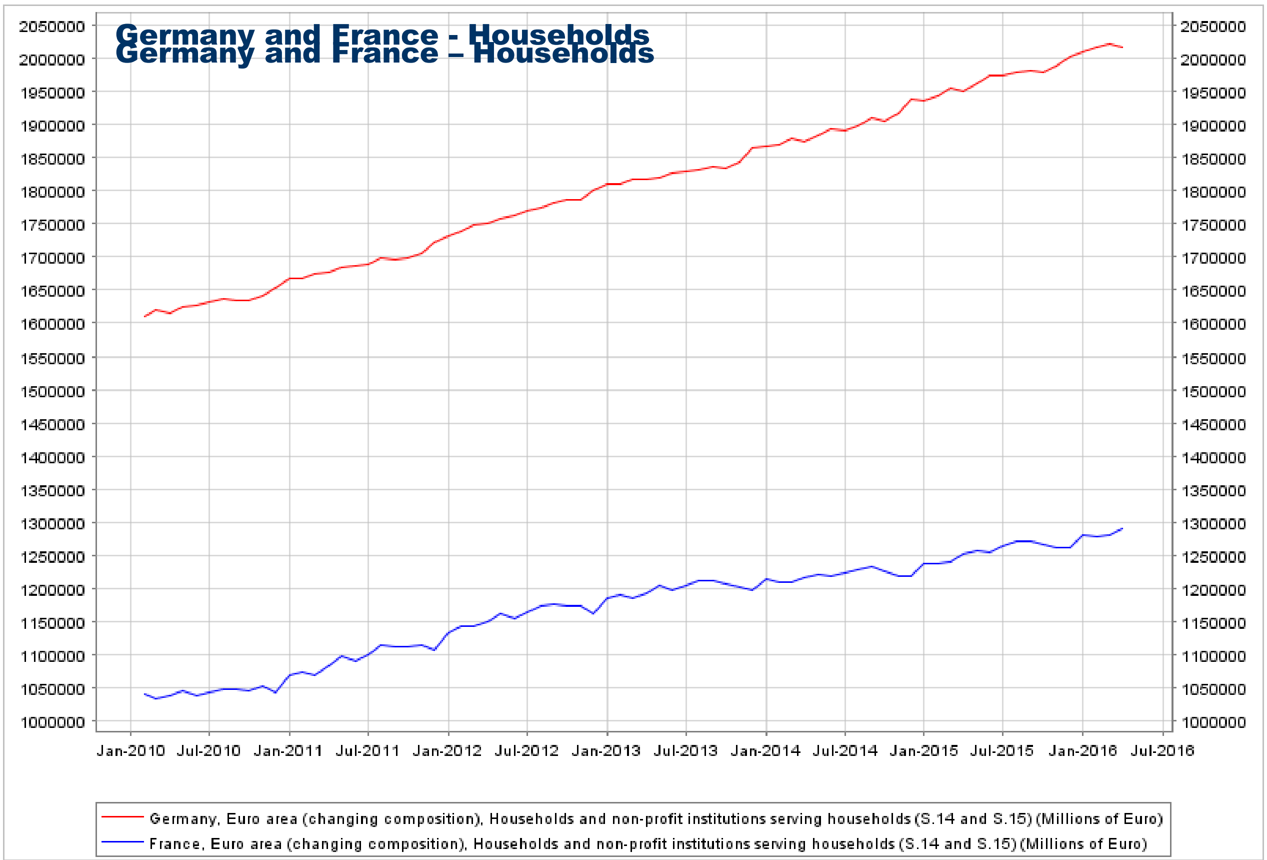
Germany and France - Households
Germany and France – Households
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2000000
1950000
1900000
1850000
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1600000
1550000
1500000
1450000
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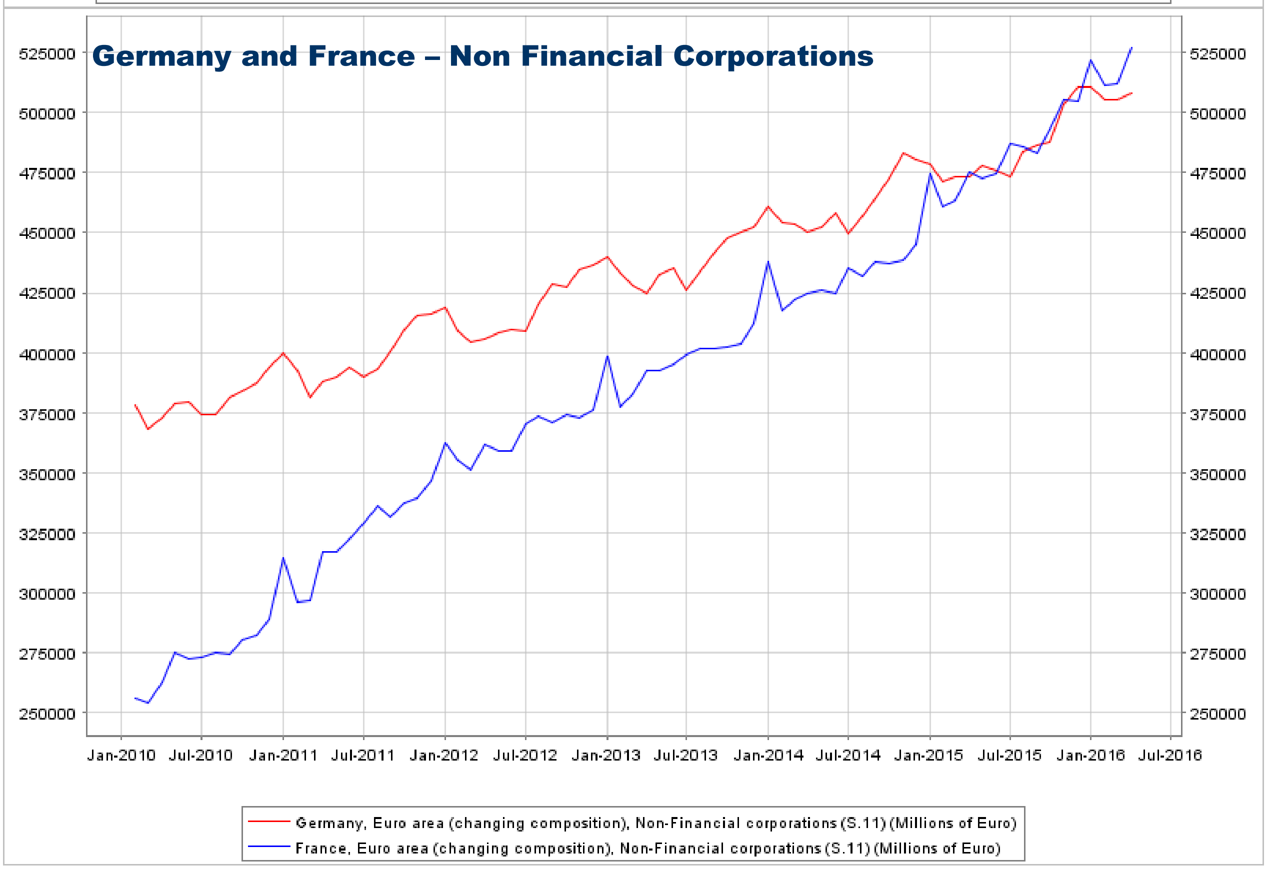
Jan-2010 Jul-2010 Jan-2011 Jul-2011 Jan-2012 Jul-2012 Jan-2013 Jul-2013 Jan-2014 Jul-2014 Jan-2015 Jul-2015 Jan-2016 Jul-2016
Germany, Euro area (changing composition), Households and non-profit institutions serving households (S.14 and S.15) (Millions of Euro)
France, Euro area (changing composition), Households and non-profit institutions serving households (S.14 and S.15) (Millions of Euro)


Germany and France – Non Financial Corporations
525000
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325000
300000
275000
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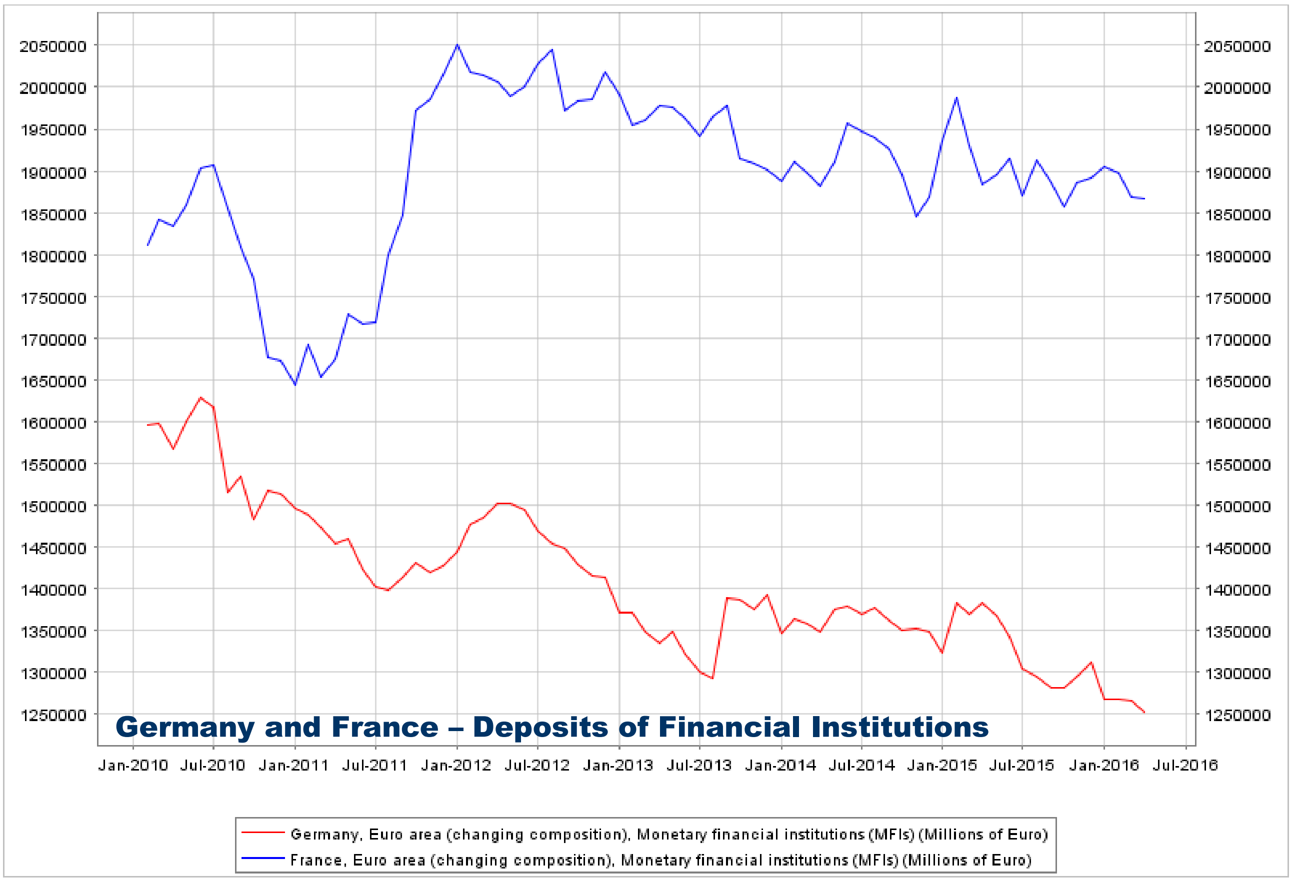
Jan-2010 Jul-2010 Jan-2011 Jul-2011 Jan-2012 Jul-2012 Jan-2013 Jul-2013 Jan-2014 Jul-2014 Jan-2015 Jul-2015 Jan-2016 Jul-2016
Germany, Euro area (changing composition), Non-Financial corporations (S.11) (Millions of Euro)
France, Euro area (changing composition), Non-Financial corporations (S.11) (Millions of Euro)

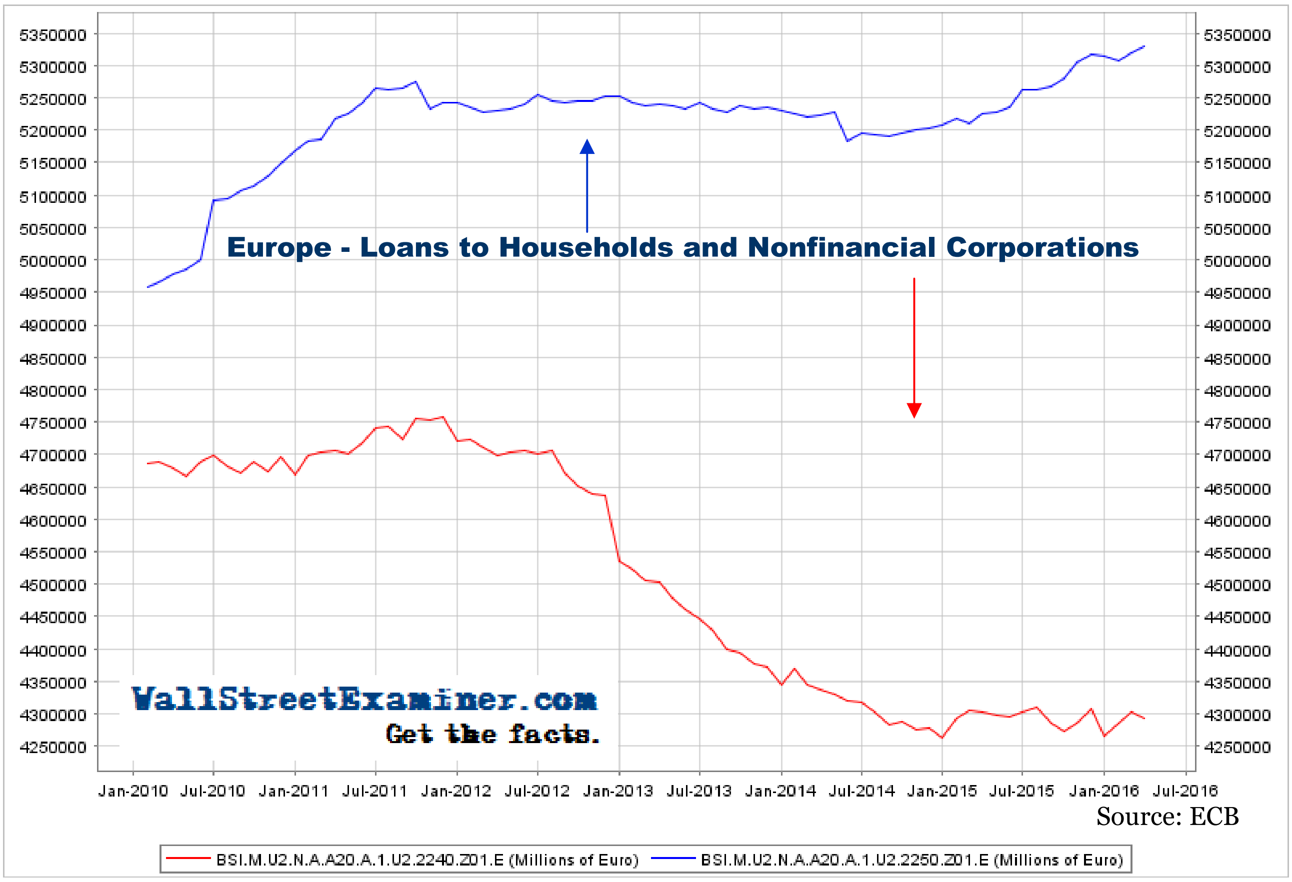
Deposits of financial institutions in other banks have been trending lower, particularly in Germany where these deposits hit new lows again in April.

3/19/16 But look what is happening to the deposits of the banks themselves in other banks. Just as I predicted they would, banks have been extinguishing deposits ever since negative interest rates were instituted. And where has that trend been strongest? In Europe's largest economy and banking system, Germany. They dropped to a new low in December even before the ECB went to an even more negative deposit rate. Then they dropped again in January. Banks will elect to use their cash deposits to pay off loans. Where will they get the cash? Why, from the ECB of course, as it buys securities from them.



Loans to households have grown at an annual rate of around 2% since October. Accrued credit card interest alone could account for most of that increase. There's no evidence of real growth in consumer lending. Loans to nonfinancial businesses in the European banking system fell to a new low in December before a dead cat bounce which has kept them just above the lows this year.

It's also notable that the TLTRO, which is the ECB's targeted loan program that was supposed to stimulate commercial lending, began in September of 2014. It has had no impact. This is just another example of central bankers acting out their delusions regardless of the feedback that reality tries to impose.



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