ECB MOVES FOR BAIL-IN

'Hjalmario' Draghi: In The Footsteps of Schacht

by Claudio Celani

June 14—European Central Bank (ECB) chairman Mario Draghi on June 5 cut interest rates down to the lowest level in history: 0.15%; introduced punitive rates for bank deposits at the ECB; and announced long-term loans to banks, as well as purchases of bonds and junk paper. Furthermore, he said that the ECB will not "sterilize" those purchases anymore, i.e., those purchases will increase the monetary mass.

Draghi himself said that the ECB has reached the limit as concerns cheap money. However, he added: "This is not the end." The next thing the Bank can do is actually throw money from helicopters.

The ECB official motivation is that the Eurozone economies need a "stimulus" in order to stop the ongoing process towards deflation. The long-term loans will be given only on the condition that banks use them for financing firms. In reality, it will be difficult, if not impossible, for the ECB to control that. Furthermore, it is not that there is not liquidity enough for banks to loan to the economy, but rather, the recession caused by the ECB policies offers no opportunities for loans. As a matter of fact, banks are filled with non-performing loans, and any cheap money injection is used in high-yield, high-risk financial investments. The ECB solution to the non-performing loans is to allow banks to package them into ABS (asset-backed securities) products and sell them to the ECB. However, this too will not work.

Plan B: 'Bail-In'

Stubbornly refusing to implement the only solution that would work, a Glass-Steagall-type of banking separation, the ECB is presumably well aware that the system is bankrupt and that its measures won't work. In its May Financial Stability Report, the ECB itself warned of a banking crash around the corner, potentially triggered by a reversal of carry-trade flows of capital from the emerging markets in the Eurozone in the last months.

Thus, the ECB must have a Plan B, different from the official stimulus narrative.

The plan is: gaining time for the big expropriation of depositors' savings, or "bail-in."

The expropriation has de facto started with the negative rates, as the head of the German Saving Banks Association, Georg Fahrenschon, has exposed. In numerous media interviews he has warned that German depositors will lose EU15 billion as result of the latest rate cut, and the ECB is pushing them to go to the stock market, where they will lose more once the market crashes.

Asked by financial journalist Dirk Müller, whether the ECB policy is expropriation of savings, Fahrenschon answered, "Yes, very clearly! Through this policy of low interest rates of the European Central Bank, private households in Germany will lose about EU15 billion yearly in interest payments. This is per capita . . . about EU200 yearly.

EC/Charlemagne

ECB chief Mario Draghi (above) the "savior of the euro" has taken up the mantle of Nazi Economics Minister Hjalmar Schacht (left, with Hitler), the "savior" of the Reichsmark.

"Draghi knows very well that when he cuts the rate, which is already close to zero, to almost zero, this will produce no positive effect in the real economy. We do not have a problem of credit supply; we have a problem of confidence."

Fahrenschon also said that the ECB is exceeding its mandate. "The European Central Bank is not the surrogate government of Germany. The framework conditions for economic actors to achieve confidence and invest—-this is the task of nation-states, of politics."

German families, faced with the prospect of losing money from their savings deposits (with rates currently at 0.2%) and life-insurance policies, will turn to the stock market. Many suspect that this is Draghi's intention. As a matter of fact, the German Dax index surpassed the historical threshold of 10,000 after the ECB decision.

Answering a question on this, Fahrenschon said: "Since the ECB is offering so much central bank money, we have an excess of offer on the secondary money circuit. Liquidity is spilling over from all corners at the moment. We talk about concrete gold [a reference to the speculative real-estate bubble]; we have one all-time high on the stock market, followed by yet another one."

Draghi already has a record in expropriating family savings: in the 1990s, when he was director general of the Italian Treasury, he forced millions of families out of state bonds into the stock market, where they collectively lost EU216 billion.

'What Damages the Depositor, Helps Balance the Budget'

However, the ominous plan, concocted among the ECB, the EU, the Bank of England (BoE), and the Federal Reserve, is more far-reaching: Once depositors are in the stock market, they become part of the global bail-in chest, i.e., their money will be used to "bail in" bankrupt banks.

The bail-in regime has been established as part of the so-called European Banking Union, which will be fully effective on Jan. 1, 2015. This legislation foresees

that in the case of insolvency of a so-called "systemically important financial institution," the bank creditors are refunded first with stocks, then with bonds, and finally, with depositors' money. Then the government steps in as the debtor of last resort.

This plan might even have been the subject of talks between Draghi and German Chancellor Angela Merkel on June 11. Shortly preceding that meeting, the head of Merkel's CDU Economic Council, Kurt Lauk, justified "the expropriation of savings" as necessary, and for the first time, said it would damage depositors. Lauk said that the ECB "rate cut also helps the government budget. What damages the depositor, helps balance the budget."

While Lauk was saying this, Jeroen Dijsselbloem, the president of the Eurogroup, comprised mainly of the finance ministers of the Eurozone countries, was in Vienna for talks on the banking situation there, and at a press conference, he told journalists that "bail-ins make a lot of sense, from both a budgetary, as well as an economic point of view," not only in Austria, which is implementing a EU900 million bail-in for the ailing Hypo Alpe Adria bank, but everywhere else in Europe.

Dijsselbloem issued a statement the same day, announcing that Eurozone member-states had just "reached a political understanding on the operational framework" for the European Stability Mechanism, mandating bail-in as part of any bank rescue operations.

Dijsselbloem had been the first EU official, in the Spring of 2013, to state that the Cyprus bail-in was a blueprint for the rest of Europe.

Even in Hungary, a country which has opposed many dictatorial EU regulations, the bail-in regime was introduced as law. On June 12, the Economics Ministry submitted a bill to Parliament establishing regulations for bail-in, according to EU guidelines. Economic Minister Mihaly Varga defended the bill before Parliament, saying the regulations will prevent the protracted liquidation of a troubled bank from triggering a crisis.

The combination of the hyperinflationary bail-out and the bail-in regime is, however, bringing the system faster to its end.

As Dijsselbloem was in Vienna hyping bail-in, Standard & Poor's announced that it had downgraded ratings for Hypo Alpe Adria and six other Austrian banks (Erste Group, Raiffeisen Zentralbank, Raiffeisen Bank International, KA Finanz, Hypo Niederösterreich, UniCredit Bank Austria), precisely because Austria is readying imposition of a EU900-million bail-in for Hypo Alpe Adria bank.

Capital Flight Out of the Euro

Draghi's negative rates policy is inflating the stock market, but is at the same time provoking a capital flight out of the euro: exactly what the ECB had warned might provoke a banking crash.

One week after the introduction of negative rates on banks' deposits at the ECB, such deposits have shrunk by two-thirds. This money is partly transferred abroad, into U.S. bonds, for instance, which have a 40-point spread with German bonds, and in general, to any country with higher interest rates. The euro has lost 2 cents against the dollar since June 5, and is now at 1.35, a one-year low. Against the British pound the euro has lost 1.2%; against the ruble 2.5%. According to "experts," the euro could go down to 1.20 against the dollar, says *Die Welt*.

And this, when Mario Draghi has not yet implemented the "unorthodox" measures.

Draghi's former colleague at Goldman Sachs and now close ally at the Bank of England, Mark Carney, made it worse by announcing that the BoE might increase its rates earlier than expected.

On June 13, he stated: "There is already great speculation about the exact timing of the first rate hike and this decision is becoming more balanced." This has been interpreted as setting an earlier date, probably Spring 2015 instead of 2016, for a rate increase. The hike is officially motivated by concerns about the real estate bubble.

Carney himself said that the move is dangerous: "The effects of an excessive, or an excessively rapid, tightening of monetary policy could prove damaging and difficult to undo." The City of London raising rates when the Eurozone reduces them, is going to amplify the carry trade (capital flight) phenomenon, with uncontrollable consequences. Popping one bubble means to pop the entire bubble, as the Fed action in 2006 shows. So, why is the BOE deciding to provoke a crash by raising rates, at the same time that Carney's twin at the ECB, Mario Draghi, is apparently doing the opposite?

One thing is sure: Mario Draghi, the "savior of the euro," is following in the footsteps of Hjalmar Schacht, the "savior" of the Reichsmark. Who will be Hjalmario's Hitler?