STATUS OF CONTINUED UNCONVENTIONAL MONETARY POLICY TOOLS

Series Abstract

A little over a decade has passed since the 2008 global financial crisis, and central banks continue to apply unconventional monetary policy tools in their effort to maintain economic stability amid slowing growth.

Quantitative easing (QE) alongside a now all-too-common negative interest rate offered by key central banks is beginning to highlight the possibility that depositors may end up footing the bill as banks find their earnings squeezed from longer than expected low rate environments.

Even the most counter-intuitive benefits, the likes of negative-interest rates on mortgages, might not swing enough demand to offset soaring fixed-asset prices against stagnant wages.

Cyclical recession fears are on the rise, and the US administration's deregulation plans are paving the way for major banks and money market makers to eye risky investments, akin to assets held in 2008, in search of better yields.

Gold has made its return to the stage, but millennials overtaking the global ageing workforce might seek different investment opportunities, having become accustomed to tech, not tradition – apps, not advisors.

Meanwhile, cash restrictions, capital controls, suffocating AML oversight demands, bail-in prospects and low deposit guarantees, put households and larger depositors in riskier positions. This is a result of increasing vulnerability among banks as revenues and profits take significant hits in the never-ending cycle of excess liquidity charges.

In the following series we will unpack the effects of these Central Bank policies on the global financial system.

Status of Continued Unconventional Monetary Policy Tools

Central Banks tasked with balancing economic progress and stability are adopting increasingly unconventional monetary policy tools in their effort to right the ship since the 2008 Global Financial Crisis.

While the most widely used tool has been quantitative easing – a method of injecting liquidity directly into the economy – major Central Banks from Japan to Denmark have had to resort to 'offering' negative interest in the view that low rates will entice private lending and increase economic activity with the everlasting hope of achieving their 2% inflation target.

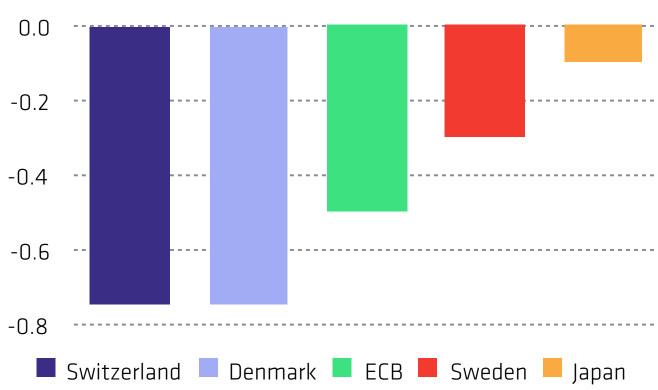
These actions have at least had some effect with stock market and fixed-asset prices at all-time-highs.

But new challenges have come home to roost within the heart of the financial sector. Commercial banks are facing fierce headwinds against their traditional business-models from tech and FinTech disruptors, negative rates, low-yield environments, strict regulatory oversight and depressed borrowing appetite.

First Open Front: Negative Interest Rates

The European Central Bank (ECB), the Bank of Japan (BoJ) and Denmark's National Bank continue setting the stage for record negative interest rates following Berlin's latest decision to further push rates in decline to new lows (see Figure 1).

Fig. 1 Central Bank Negative Interest Rates Have Taken Hold Over Several Major Economies



Sources: Swiss National Bank, Danmarks Nationalbank, European Central Bank, Sveriges Riksbank, Bank of Japan (October 2019).

Denmark – who was the first major economy in the world to start offering negative interest rates in 2012 – was recently forced to increase charges on excess reserves yet again in order to maintain its Krone peg close to the Euro after the ECB lowered its interest rates even further.

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While the United States Federal Reserve has not yet ventured into negative interest rates and probably remains unlikely to do so in the near-term – despite recent calls by US President Donald Trump – the phenomenon has become the norm for over half a decade in some of the largest global economies (see Table 1).

Tab. 1 Half of Top 10 Global Economies Face Banking Pressures From Neg. Rates

Country	Notes	Rate
USA	Healthy Outlook	+
China	'Trade War' with US	+
Japan	Banks Highly Exposed to Foreign Bonds & Stocks	-
Germany	Economy Contracted, Recession Fears	-
UK	Brexit Uncertainty	-
India	Interest Rates Hit 9-Year Low	+
France	Healthy Outlook, Outpaces Germany	-
Italy	Unstable Government	-
Brazil	Heavy Forex Intervention, Record Low Rates	+
Canada	Stable Outlook	+

Sources: Federal Reserve, Bank of China, Bank of Japan, Deutsche Bundesbank, Bank of England, Reserve Bank of India, Bank of France, Bank of Italy, Central Bank of Brazil, Bank of Canada (October 2019)

"That [negative interest rates] have simultaneously appeared in several European countries at a time when global financial markets are not in crisis is unprecedented" was the position of the World Bank in 2015.(1) Nearly 5 years on, negative interest rates have become the expected norm in what is financially speaking the largest expansion period in recorded world history.

Tomayto Tomahto?

Although European/US spillover-risks from unconventional monetary policies are limited according to a recent study by the Federal Reserve,(2) any crisis sparked from a now squeezed European banking sector could very well once again cause global contagion.

Intertwined global markets are being affected by low yielding bonds and investors are either hoarding cash – as is the case in Europe – or venturing into riskier investments.

According to Bank for International Settlements (BIS), Japan has now had to expose itself to record high investments in foreign assets for the first time following zero rates, negative rates and continued stimulus (3). It now warns that Tokyo is vulnerable to currency swings and external shocks, threatening financial stability in the world's third largest economy.

Revenues Down, Profits Down

Cracks are already beginning to show across the board. 1H19 revenues for major US and European investment banks are down 11% versus the same period in 2018, the slowest half since just before the global recession according to data by S&P Global Coalition.(4) Revenues mark a 13-year low.

Danish banks for 1H19 have seen their profits fall 20% in comparison to last year according to banking association Finans Danmark (5). The decline comes off a 2017 peak, but continuing low interest rates and subdued demand for loans have pushed profits for 17 banks down by 36% in 2 years.

Ulrik Nødgaard, Finans Danmark CEO, said that "we are in a situation where the Dane's demand for new loans is only slightly increasing, even though we are six years into an economic recovery ... demand for new loans remains restrained."(5) The cautious tone comes amid the first negative interest rate mortgage being offered in Denmark just last month at -0.5%.

And there is no end in sight to the spiral that has, for all intent and purposes, done the opposite of its primary intention in assisting economic activity through lenders. Banks are now finding themselves between a rock and a hard place having to make bold decisions on either charging their clients on their deposits and risk them leaving, or bear the brunt of excess reserve charges, further squeezing profitability.

The irony is not lost on anyone that banks are now charging a rate on wealthy depositors who, in effect, are loaning funds to financial institutions. The cherry on top is the risk taken on by depositors as fund safety in bank failure scenarios can result in devastating losses, with lukewarm deposit guarantee as their only protection (see Table 2).

Tab. 2 Deposit Guarantees in the Case of Bank Failures / Bail-Ins

Country	Insured	Currency	USD (Approx)
USA	250,000	USD	250,000
Norway	2,000,000	NOK	230,000
Australia	250,000	AUD	175,000
UK	85,000	GBP	110,000
EU	100,000	EUR	110,000
Switzerland	100,000	CHF	100,000
Canada	100,000	CAD	75,000
Hong Kong	500,000	HKD	60,000
Malaysia	250,000	RM	60,000

Sources: Federal Reserve, Norges Bank, Reserve Bank of Australia, Bank of England, European Central Bank, Swiss National Bank, Bank of Canada, Hong Kong Monetary Authority, Bank Negara Malaysia (October 2019)

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Swiss banks were the first to kick off what, for client retention, remains a rather risky practice. UBS now charges its depositors with over EUR 0.5m 0.6%, while Credit Suisse takes 0.4% on accounts holding more than EUR 1m.

Swiss account holders aren't the only depositors who are being levied. The very same Danish Bank, Jyske Bank, that now offers negative-interest rate mortgages, has also had its arm twisted in applying a -0.5% rate on deposits over DKK 7.5m (approx. EUR 1m). Sydbank, one of Denmarks largest financial institutions has announced the same.

Even in Japan – where the prospect has been on the table for a decade – signs are beginning to point towards a break away from the taboo of bank charges on depositors. Hiroshi Nakaso, Deputy Governor of the Bank of Japan, said that "the social norm in Japan is something along the lines of 'there is no way that fees are charged on hard-earned money deposited in a bank.' But I think the time has come for the Japanese people to discuss fair compensation for financial intermediation services."(6)

And while the rest of Europe remains reluctant to take measures which pass through the negative interest rate to depositors, it also leads to the erosion of profits led by narrowing bank net interest margins. In effect, the sustainability and health of banks are being put on the ropes once again.

One Way or the Other…

While bank failure stopgaps since the global recession have been implemented, the mechanisms remain untested. And raising bail-in debt to meet Central Bank reserve requirements might bring banks even closer to the edge as it cuts even further into their profitability.

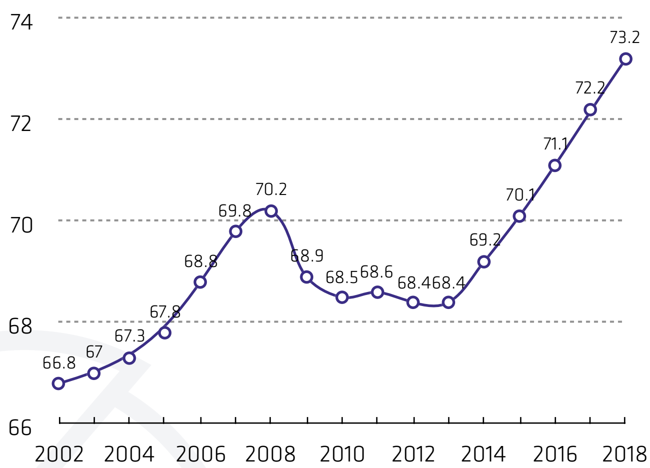
UBS puts the number at 450Bn Euros that EU banks will need to raise this year alone in order to meet the minimum requirements.(7) This is likely to continue growing as bank assets balloon to numbers larger than before, now even bigger than the "too big to fail" mantra of 2008.

Employment Up, Savings Up

Eurostat places the European Area employment rate to have hit an all-time-high for ages 20 through 64 (see Figure 2). However, the job recovery isn't all that it seems as wages have remained stagnant across the EU, limiting spending on fixed-assets whose appreciation have ballooned to levels even the 'cheapest' money can't buy.

And depositors aren't giving banks much reprieve either. According to Eurostat, higher savings rates are adding fuel to the fire of now costly bank deposits. (8)

Fig. 2 European Union Employment Levels at All-Time-Highs (Ages 20-65)



Source: Eurostat

No Option Without Risk

While US banks remain solid on the back of strong economic policy, cross-border effects from Europe and Japan, along with the US/China trade war have sparked fears of a soon-to-come global recession.

The safety and health of these banks, while still in the green, are facing challenges to their traditional business models. Bail-in procedures have become law.

More monetary tools are still in play, and the likelihood of further expansion of cash-limits adopted worldwide will be key to even more control over macroeconomic policies by regulators.

Such concerns have already marked the return of investors to gold markets, or moved new funds into Bitcoin which has now established itself as an institutional store-of-value given the availability for trading from the Nasdaq to futures on the Chicago Mercantile Exchange (CME).

The next part of this series of Macro Perspectives by CoinShares will unravel the Wealth Storage Options and Associated Risks.

- Deposits: Banking Risk
- Cash: Inflation and Transactional Risks
- Hard Assets: Liquidity Risks
- Markets: Valuation Risks
- Gold, Bitcoin and Metals: Return and Volatility Risks

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