Hello Everyone,

“How does it help…to make troubles heavier by bemoaning them?”
Seneca

Today’s missive bemoans what is happening inside our banking institutions. Seneca would not approve.

Oh, and the content is not anything you would ever hear on CNBC or Fox Business. It does, however, speak to something that is unprecedented in modern finance/banking.

I’ve hesitated taking on this issue, because terms like Reverse Repos tend to make peoples’ eyes glaze over. But the situation is becoming so (uhhhhhhh) severe I couldn’t ignore it anymore. Maybe it will sort out. I hope so.

Finally, since I can’t do the KKOB spots anymore---because of the Governor’s run---I have invented “Imaginary Bob” or “I-Bob” to make my point today. And no. I am not seeing imaginary radio hosts :>)

Signed, Your Does-Anyone-Else-Find-It-Ironic-That-California-Is-Discouraging-Charging-Electric-Vehicles-Because-It-Uses-Too-Much-Energy? Financial Advisor,

Greg

Zanetti Monday Missive 2021.07.12 Wells Fargo & The Fed

I-Bob: So, Greg, today we are looking into some strange goings-on inside the banking world, right?

Greg: We are. So, Bob, I am going to make you the CEO of Wells Fargo. Of course, your job is to make money for the bank by lending money and making interest on those loans

Therefore, it is in your best interest to loan as much money as you can at the highest possible interest rate, right?

I-Bob: Right. But I also want to loan to people who can pay me back. I don't want a lot of defaults.

Greg: Right. So, let's go a little deeper. We all know the Federal Reserve is printing trillions. What the Fed does with most of this money is it pushes it down to its member banks. Like you over a Wells Fargo. The Fed hopes you will lend it to help get the economy moving.

But here is where it gets interesting. The Fed has printed so much, the banks are stuffed with cash. They don't know where to lend it.

So, you Mr. Wells Fargo CEO have a dilemma. What do you do with billions in cash sitting at your bank earning next to nothing? Well, the Fed has a mechanism for times like this and it is called a Reverse Repurchase Agreement…or a Reverse Repo.

In short, the Fed ***will repurchase the cash*** (!) they sent to you and pay you a little bit of interest on it.

I-Bob: So, wait.

- The Federal Reserve gave me billions of dollars.
- They hoped I would lend it out.
- But, for whatever reason, I did not.

- So, rather than have a bunch of idle cash sitting at my bank, I can give that money back to the Fed and earn some interest on it.

Do I have that right?

Greg: You do. Which is why last week's headline was so weird. It read:

Wells Unexpectedly Shuts All Existing Personal Lines Of Credit, Hinting US Economy On The Edge

Bob, in short, Wells Fargo is pulling the rug out from under their customers with $3,000-$100,000 lines of credit. Think their small business customers.

And here is why this is weird.

As you know, many businesses have a line of credit…think of it as a credit card at the bank. This allows the company to buy inventory ---or manage their cash flow--- as business ebbs and flows. For example, a business might tap their credit line for $20,000 to buy some product for the summer season. Then as they sell it, they pay the credit line back.

Well, the interest rate the bank gets on that line of credit might be 5%-6%. Not bad.

In contrast, if the bank decides to park the money at the Fed, they only get .5%. So, Mr. Wells CEO, what would you rather do, loan your money out at 5-6% or park it at the Fed for half a percent?

I-Bob: That' obvious. I would rather loan it out at 5-6%. So, why would Wells Fargo be cancelling lines of credit where they earn a whole lot more in interest?

Greg: Ahh, indeed. And Wells Fargo is not alone. The Federal Reserve is now seeing up to a trillion dollars being parked in its accounts by all kinds of financial institutions. On a chart it looks like a rocket taking off. So, what is now happening is this. All this money the Fed is printing is not being pushed out into the economy as the Fed had hoped. Rather it is being recirculated right back up to the Fed at a tenth of the interest rate the banks could get if they loaned it out.

So, circling back to your question. Why?

Well, the last time we saw this was in the spring and summer of 2008--- just before the Lehman crisis when the housing bubble popped. Many of your listeners remember that. The banks saw something early and did not want their customers drawing on their lines of credit. Especially if they thought those lines might not be repaid.

I-Bob: So, is this what you think is happening now?

Greg: I don't know. But a trillion being parked at the Fed rather being loaned out tells me one of two things:

- The banks are not confident they can loan with confidence…even on a short- term basis.
- Or the banks are forcing their customers to use their ***bank credit cards*** at 15%-18% in lieu of their lines of credit.

I-Bob: So once again, it is the little guy who is getting the raw deal. I'm sure this isn't happening to the big box stores.

Greg: Nope. So, are the banks expecting another Covid-esque shut down later this year? Are they concerned about some shock we don't know about? Or do they just want to pump up their bottom line by charging credit card interest vs. line of credit interest? My guess is we will find out soon enough.