www.better-management.org provides invaluable insights that will help you understand and deliver better organizational performance.

Better-Management Newsletter 7 October

Early warning time. Is it time to think about bail-ins in NZ and Australia?

Well it sure is in Europe! We have been reading all about Deutsche Bank and the Italian banks.

Besides George Soros (who is always shorting some poor corporation or country), there are other commentators already pre-judging the outcome of the Italian referendum that is to be held on 4 December 2016. One is the Casey Research team... but this is worth a read because I think they are probably not too far wrong....if things continue the trend towards going "pear-shaped" that is...

http://www.internationalman.com/articles/heres-where-the-next-bank-deposit-bail-in-will-strike

Of course we now have the bank bail-in empowering laws in New Zealand already, so that if a smaller NZ bank or one of the big Australian banks have a hard time, they can confiscate a proportion of our savings too. The only two things that would need to be determined (during a bank holiday for them... and for the Government to figure out and agree the details) would be the threshold of how much each person must have in the bank before they get "robbed"; and the proportion over that amount that gets taken. For example, we can presume that everyone with less than NZD100,000 in the bank would not be affected because it would mean the government would get tossed out at the next election. But would the threshold be $150k, $200k or what?

Like with Cypress in 2013, this would be a purely political decision. If you recall, in Cypress they had Eur100,000 as the limit and that equates to almost NZD200,000. What proportion of the excess over that minimum could the bank take?

In Cypress it then caused mayhem for the Russian Oligarchs who were caught, happily laundering their money there into Euros and it also hit a lot of the retired ex pat community (often British). Most of the normal Cypress folk escaped and only a few of their wealthy got caught out.

I never found out what the percentage figure used for confiscation was, but from the above link you can see what the pain a few Italian bank insolvencies caused people. Even the banks closing their doors for all transactions for a month or more – called a "bank holiday", would have caused severe hardship for all those people living from pay cheque to pay cheque.

John Key returned from a G20 meeting in 2014 impressed by the fall-out of the derivatives contagion.... and immediately changed the law to make "bail-in's" legal.

Of course he never called it a "Bail-in" because he did not want to frighten the horses...i.e. you and I. That is why the empowering legislation in NZ refers to it as "Open Bank Resolution". They will just open your bank account and take what they need, when they reckon they need it. The money taken then gets added to the bank's capital...and hey presto the bank is solvent again. Good luck getting your money back. Bank share prices would hit rock bottom and it would be many years if ever, that you could get some or all of your money back.

Remember that Mr Key isn't just your Prime Minster, his career history puts him firmly as one of the "Bankster class", so he probably knows the full extent of the risk for the collapse of the global financial system. The same applies to the Australian PM, Malcolm Turnbull. I would be inclined to bet that by the time any bank holidays happened for kiwis, very little of their personal wealth will be caught by bail-ins. (Sorry to seem not very charitable about that, but professional fund managers like his have already had plenty of time to take precautions against being caught.)

When the US Fed needed to loan out more than USD16 trillion in 2009-10 to rescue the world's banks (including at least one of our own Aussie banks – possibly two), even John Key must have been told how close to the precipice the global financial system had travelled.

I think the correct words for that were "teetering on the edge".

However the Government will only do a bail-in once they have figured out how much your bank will need.... and how to do it without getting chucked out of office. It must take some time to do that out with modelling scenarios based on how much is needed and how many voters would be impacted. Then the parliamentary vote to share the public's displeasure around.

If you have been reading my emails and have understood the risk and been able to do something about it, you may already have a month or two of cash under your mattress in readiness for the almost inevitable bank holiday that John Key is preparing us for. How else could you otherwise last for a month or so, with no access to your bank account or to wages? Perhaps even a parent or other family member has made preparations to cover you?

By now you probably have no more than $100,000 per person in any one bank.

You may also be prepared for the inevitable result of excessive money printing and credit creation on the value of our fiat currency, by having precious metals in low denominations....... such as a small supply of 1oz silver coins that cost $35 each, or 0.25oz gold coins that cost $500 each.

These may of course turn out to be wasted precautions. Nothing is certain and the timing of any possible event cannot be predicted.

For us, bail-ins may prove to be a " very low probability event" in the immediate future....even with a share market crash. But in the event of a share market crash, that would be one indicator for us of the timing for problems to come. The trigger for banks' liquidity/solvency issues becoming un-manageable could more likely be contagion from overseas – such as a global derivatives meltdown in the hundreds of trillions.... such as with CDSs when major counter-parties fail - or locally, a steep decline in residential and/or commercial property values in Australia and New Zealand. If that occurred, banks would have reduced collateral and probably with rising interest rates and a falling dollar, these could inflate the currency of repayment. Things would happen very fast given the high proportion of Australasian bank debt invested in residential property on both sides of the Tasman.

Perhaps we should take note of the old saying, “The bull climbs the stairs, but the bear jumps out of the window”. Crashes always happen with amazing speed when they get under way. The GFC happened over one weekend. On Friday there was apparent normalcy, but by Monday all major interbank transactions had frozen. However despite mayhem for the TBTF banks on Wall Street, it took some time before the worst affected European banks had bank holidays. The next time we have a crash it will probably happen with similar speed. There may be little use lining up at our bank or ATM on a Monday morning to withdraw cash, because by the time we heard about the problem, the bank run would already be under way and few/no funds would be available.

In Greece, after the end of their bank holiday (it actually took a couple of months of bank closure) the Greek Government implemented capital controls and that meant the amount that people could withdraw was limited to EUR 400 per week per person.

Of course the Greek banks owe the German (and other European) banks a huge amount of money so they demanded repayment according to negotiated schedules. That means ever more austerity for Greeks and this is why pensioners have progressively had reductions in pensions of between 25-45%. No wonder they are marching in protest. This winter they will probably again be trying to heat their houses from firewood they gather from the parks and forests – or else freezing in their homes.

For pensioners in the OECD, most already have greatly reduced income streams due to ultra low (and even negative) interest rates on their investments and the reduced earnings of their pension schemes.

In NZ and Oz we have a number of advantages over the other OECD countries that we should be thankful for. But it remains to be seen if those will provide much of a cushion.

Thus far, I have spoken about a possible problem and its remedy on a personal level, but only in the short to medium term. Personal longer term remedies are available and in previous emails I have discussed those.

For our society as a whole it is a different matter. Society’s predicament will be far harder to deal with.

On a macro-economic level, causation is not just poorly understood but all relevant economists appear to be in denial. OECD governments have been trying to paper over causation for deteriorating economic circumstances for the last 20 years. I therefore have no idea how they can solve the issues that confront them now. A simple analogy may help....

It seems like we are trying to drive from Auckland to Wellington by heading North, when the driver also has no idea of which direction to go in, to reach Wellington. The folk driving our policy will have us in the sea before they change direction.. if only because the GPS they are using says we must go that way.

Winston Churchill is reported to have said (with thanks to John Mauldin), “No matter how beautiful the strategy, you should occasionally look at the results”.

Twenty years ago economists rejoiced that the “multiplier principle” meant that $1 of debt would generate $3-4 of extra GDP.

Today economists are a little puzzled because it takes $3-4 of debt to create $1 of extra GDP. The trend is still worsening and it isn’t the fault of people who are opposed to, or suspicious about the TPPA. Now, the problem with that change is that this means no governments so affected can ever repay their debt...

Where has that damned “multiplier principle” gone wrong?

Next time we see Christine Lagarde of the IMF on TV. We will likely see her pitifully asking governments to ramp up their incentives to increase free trade and domestic consumer spending. Yet international trade is already down and consumers are already in debt up to their eye-balls.

For Christine, her IMF, and the folks at the BIS (the central bank of central banks), the blame game has already started. It can’t surely be the fault of Donald Trump that economists and central bankers went off the rails some 10-15-20 years ago?

But IMHO this is still just an early warning of what I think is to come.