# Economic Impact of Covid-19:
## The Role of Banks and Financial Markets

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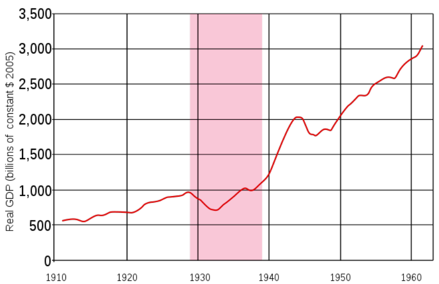
## Outline

- We focus on the extreme monetarist economic policy implemented as US response to Covid-19 and its likely effect on banking and financial markets
- An unprecedented, simultaneous use of all three policy tools is combined with widespread use of algorithmic trading to manipulate prices of traditional 'safe-haven' assets such as gold and bitcoin. These strategies artificially increase prices of US assets and manipulate the value of the US dollar
- In fact, ever since the Great Depression of the 1930s, currency and gold price manipulation, plus sustained economic stimulus have been deployed to mask the true weakness of the US economy

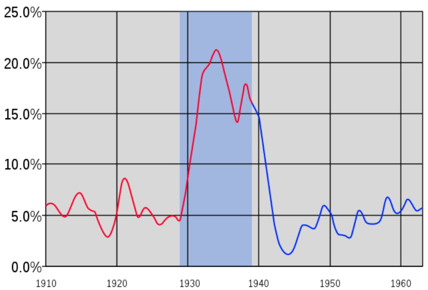


## The Great Depression

US GDP




US Unemployment Rate




After the stock market crash of 1929, high unemployment in the US → deflation

→ The US government aimed to increase exports via US dollar devaluation

→ To fund infrastructure and boost manufacturing, also increased money supply



## Franklin D. Roosevelt (1933 – 1945)

Changing gold and silver from currencies to commodities

1934 Gold Reserve Act


POSTMASTER: PLEASE POST IN A CONSPICUOUS PLACE.—JAMES A. FARLEY, Postmaster General

UNDER EXECUTIVE ORDER OF THE PRESIDENT

Issued April 5, 1933

all persons are required to deliver

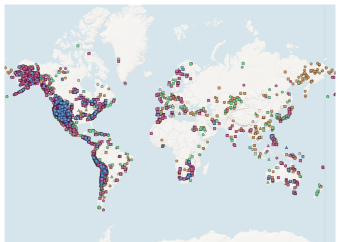
ON OR BEFORE MAY 1, 1933

all GOLD COIN, GOLD BULLION, AND GOLD CERTIFICATES now owned by them to a Federal Reserve Bank, branch or agency, or to any member bank of the Federal Reserve System.

Executive Order

Confiscated @ 1 oz. = \$21
Revalued @ 1 oz. gold = \$35
\$2bn profits → ESF
Exchange Stabilisation Fund
Result 1: US dollar ↓

1934 Silver Purchase Act

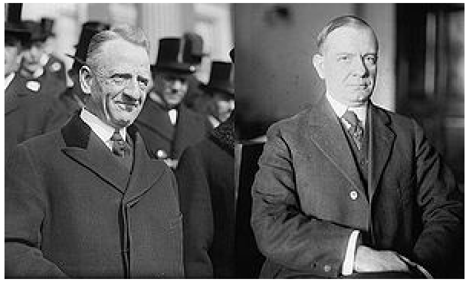


50% seigniorage → silver certificates
Result 2: ↑ silver price
Result 3: ↑ money supply

# Role of Commercial Banks

Commercial banks contributed to the 1920s stock market bubble by finding a loophole in banking laws, setting up subsidiaries, now called investment trusts, to trade in stock markets

1932: Glass-Steagall Act

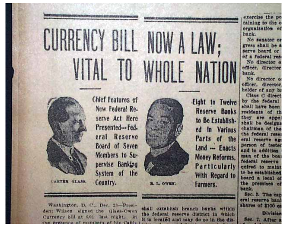


Clear distinction between activities of commercial and investment banks



# Role of Central Bank

Extension of 1913 Federal Reserve Act → 1933 Emergency Banking Act


CURRENCY BILL NOW A LAW; VITAL TO WHOLE NATION

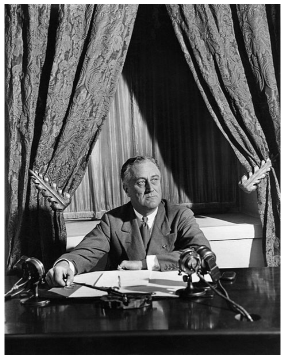
Federal Open Markets Committee (FOMC)

- Federal Reserve Bank Presidents + Board Members
- Controls interest rates and the money supply, issuing and trading treasury securities in open market operations



# Role of Social Media

Second Downturn in 1937



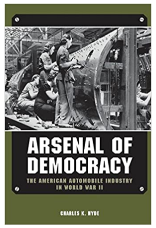

Text of Roosevelt's Fireside Chat Explaining New Recovery Program

1938 Accounting Reforms → Ban on Market-to-Market (MtM)



# Recovery from Great Depression

With the outbreak of WW2 car manufacturing almost ceased → changed to manufacture military equipment




- 2,600,000 trucks
- 600,000 jeeps
- 50,000 tanks
- Planes, guns, bombs


Unemployment ↓ Industrial Production ↑ 15% p.a.

Gross National Product ↑ from $88.6bn in 1939 to $135bn in 1944

## Stabilisation of Exchange Rates

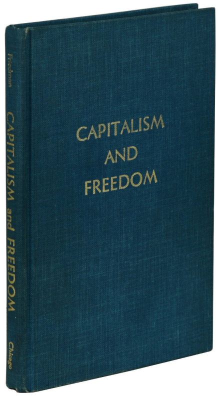

- In 1944, all 44 Allied countries met in Bretton Woods, USA led by economists John Maynard Keynes (UK) and Harry Dexter White (US)
- Agreed to peg their exchange rates to USD within 1%
- US agreed to adhere to gold standard: 1oz. gold = $35
- Bretton Woods Agreement gave permanent authority to ESF

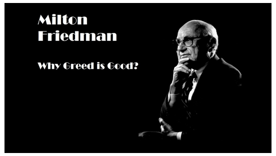


## Development of Financial Markets

1950's and 1960's — The Birth of Monetarism

Efficient market economics rather than stabilising exchange rates




- Milton Friedman focus was on restricting the money supply to control inflation
- Greed-is-Good philosophy → middle classes replaced commercial banks role in stock price booms



## Stock Prices Boom — without Re-Investment of Profits

- By 1965, 60% of company stock was owned by the middle classes
- But only 6% of profits were re-invested in the company
- 45% went to shareholders and the rest went to highly-paid executives

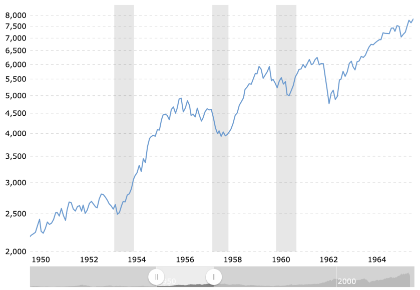


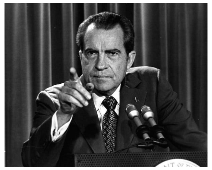

*Figure 4: S&P500 returns for individual decades since 1940*
*Source: Bloomberg, Guinness Atkinson Asset Management*

| | Total return | Price appreciation | Dividends | Dividends as % of total return |
|---|---|---|---|---|
| 1940s | 143.1% | 34.8% | 108.3% | 75.7% |
| 1950s | 467.4% | 256.7% | 210.7% | 45.1% |
| 1960s | 109.5% | 53.7% | 55.8% | 51.0% |
| 1970s | 76.9% | 17.2% | 59.7% | 77.6% |
| 1980s | 389.2% | 227.4% | 161.8% | 41.6% |
| 1990s | 432.2% | 315.7% | 107.5% | 25.4% |
| 2000s | -9.1% | -24.1% | 15.0% | *Not meaningful* |
| *Average* | *228.6%* | *125.9%* | *102.7%* | *52.7%* |



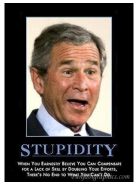
## Nixon, Clinton and Bush

- 1969 – 1974: Richard Nixon
  1971: Dropped the Gold Standard

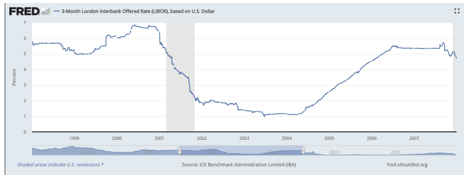


- 1993 – 2001: Bill Clinton
  1999: Repealed Glass-Steagall Act


- 2001 - 2009: George W. Bush
  2007: Reinstated MtM Accounting

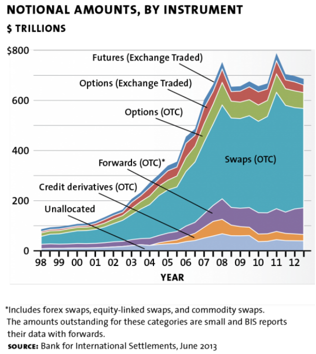


## Derivatives Notional Exceeds 10 × World GDP



- Expansion of interest rate swaps driven by accounting rule discrepancies: MtM vs. Cash
- Notional traded on financial derivatives soared as all banks searched for yield

- Following recession of 2001-2 Alan Greenspan kept interest rates too low for too long

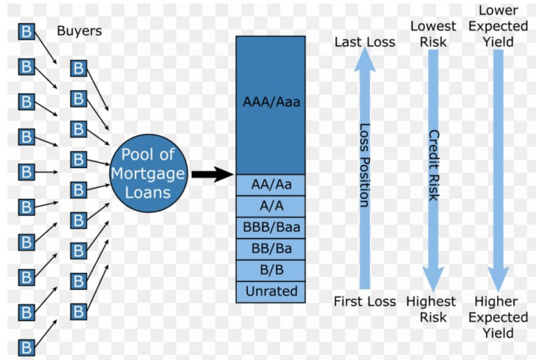





## Role of Investment Banks

Securitisation of sub-prime debt (MBS)

- Investment banks underwrite collateralised debt obligations (CDOs)
- And even sell credit default swaps (CDSs) on CDOs they hold!



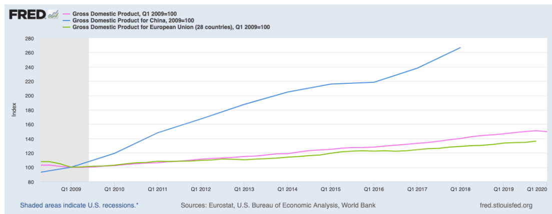



## 2008 – Investment Banks Collapse


- Credit crisis → CDOs toxic debt
- But rating agencies colluded with investment banks → tranches retain good credit ratings
- US banks effectively exported a toxic financial bomb to Europe and Japan
  → 2011 European sovereign debt crisis
- Nevertheless Federal Deposit Insurance Corporation (FDIC) closed 465 US banks from 2008 to 2012
- $250bn investor run on Money Market Funds (MMFs) stopped by US Treasury using ESF guarantee

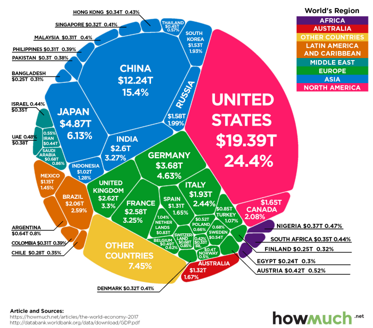


## Economic Growth from 2009 to 2019




In 2019:

- China GDP ∼ $15tr
- EU GDP ∼ $18tr
- US GDP ∼ $22tr



# FOMC Operations Before the Pandemic

## 2009 – 2017: Three Rounds of QE

- Did the US economy ever really recover from 2008?
- Has it just been propped up by continual rounds of QE?

## 2017: Unwinding of US National Debt

- QE stops ⇒ Deflation of Federal Reserve balance sheet
- ⇒ Money market squeezes ⇒ US stocks ↓

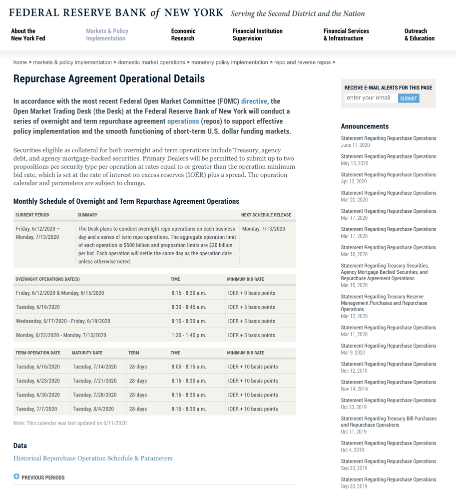
## 2019: Repurchase Operations Begin

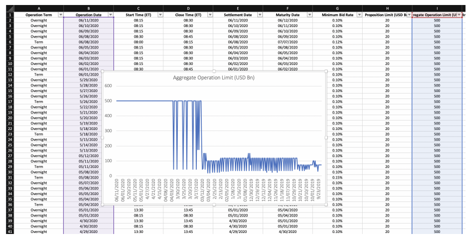
- September 2019: first interest rate cuts since 2008 and
- \$60bn T-Bills issued per month + overnight repos by Fed



# Impact of Covid-19

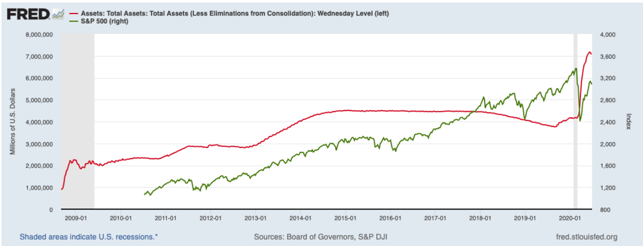
## FOMC Shock Announcement on 16 March 2020

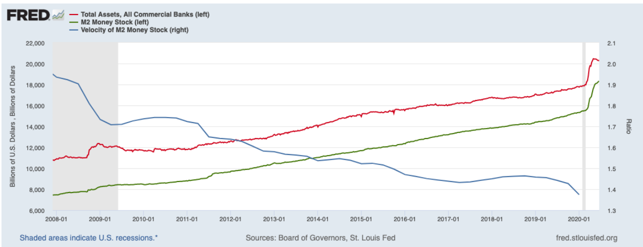





# Balance Sheet Expansion \$1tr ↑ \$7tr



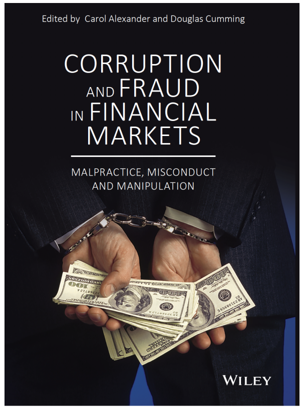



# QE Goes Global → Markets Dislocate



US dollar defends returns on US stocks and bonds

# No Safe Haven





FEATURED
by Kai Sedgwick
Mar 6, 2020

Bitcoin History: When DDoS Attacks Made BTC's Price Drop

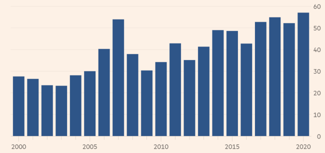


# Hedge Fund and Investment Bank Profits

**Single-Manager Hedge Funds**

| | May-20 | Apr-20 | 2020 YTD | 12 Months |
|---|---|---|---|---|
| **Hedge Funds** | **2.89** | **5.67** | **-2.95** | **1.80** |
| HF - Event Driven Strategies | 3.72 | 5.91 | -7.54 | -4.58 |
| HF - Equity Strategies | 3.63 | 7.37 | -5.11 | 1.73 |
| HF - Credit Strategies | 1.74 | 1.96 | -5.66 | -3.01 |
| HF - Relative Value Strategies | 1.70 | 2.35 | 0.38 | 3.23 |
| HF - Macro Strategies | 1.59 | 2.99 | -0.03 | 5.68 |
| HF - Multi-Strategy | 1.43 | 5.21 | -2.59 | 2.71 |
| Activist | 3.85 | 7.62 | -7.80 | -1.32 |
| Discretionary | 3.19 | 6.32 | -4.37 | 1.32 |
| Volatility | 1.87 | 4.12 | -1.01 | 4.18 |
| Systematic | 1.47 | 3.91 | -0.02 | 1.85 |
| HF - North America | 4.36 | 7.22 | -1.41 | 4.14 |
| HF - Emerging Markets | 2.73 | 5.30 | -6.60 | -0.30 |
| HF - Developed Markets | 2.51 | 4.24 | -3.41 | 2.28 |
| HF - Asia-Pacific | 2.32 | 5.55 | -4.46 | 0.92 |
| HF - Europe | 1.34 | 3.83 | -4.86 | -1.48 |
| HF - BRL | 3.22 | 5.14 | -6.11 | 3.61 |
| HF - USD | 3.08 | 5.95 | -2.46 | 2.14 |
| HF - GBP | 2.95 | 3.99 | -3.81 | 0.71 |
| HF - EUR | 1.86 | 3.54 | -3.42 | -1.45 |
| HF - JPY | -0.26 | 1.97 | -6.97 | -4.11 |
| HF - Large ($1bn plus) | 3.19 | 5.01 | -1.48 | 4.48 |
| HF - Emerging (Less than $100mn) | 2.85 | 5.88 | -3.88 | 0.53 |
| HF - Medium ($500-999mn) | 2.66 | 4.62 | -4.94 | 0.02 |
| HF - Small ($100-499mn) | 2.55 | 4.38 | -4.18 | 1.76 |

Investment banking fees hit a record in the first half of 2020
Year-to-date global investment banking fees ($bn)




All figures year to date
Source: Refinitiv
© FT

Total investment banking fees are up 9 per cent from the first half of 2019, according to Refinitiv. That includes a 30 per cent jump in revenues from underwriting bonds and a 37 per cent rise in fees tied to stock sales.

INVESTMENT BANKING

**Deutsche Bank first quarter investment bank profit beats all of 2019**

Profits in the division were €622m, nearly 150% up on the same period last year and more than the €445m it made in the whole of 2019

By Paul Clarke
April 29, 2020 8:35 am GMT

Deutsche Bank's shrunken investment bank generated more profit in the first quarter of 2020 than it did in all of last year as the German lender benefited from a huge upswing in bond issuance and increased trading revenues because of the Covid-19 crisis.

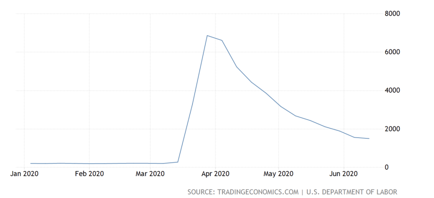


# US Household Economics

Today there is $14.3tr of household debt in new CDOs. Toxic debt is not limited to MBS – car loans, credit card debts and student loans have all been massively securitised by banks and P2P lenders

Four US government stimulus packages (so far) pledge about $3tr to help small business and consumers, aims to prevent wave of defaults triggering another credit crisis

50 million new jobless claims in the US since March 2020




Real unemployment rate 24% or more



# Credit Crisis Looms

## Term Asset-Backed Securities Loan Facility

- Federal Reserve banks and Blackrock are buying $300bn of securities backed by consumer loans MBS, car loans, credit card debt, student loans ...
- They are also buying new corporate debt in exchange for credit lines up to four years, for all investment-grade companies (e.g. GM alone has a credit line of $2bn)
- Also buying corporate debt in the secondary market – around $2.5bn of large corporate bonds (AT&T, Berkshire Hathaway Energy, McDonalds, etc) and corporate bond exchange-traded funds

## ESF Bailout for Money Market Funds

Covid Aid Relief and Economic Security (CARES) Act of 27 March 2020

ESF → \$500bn for general "bailouts" – including MMFs

- MMFs are high-quality short-term assets – like bank deposits but not FDIC guaranteed
- Sector provides \$4.8tr of liquidity, but with zero (or negative) interest rates MMFs again threatened by investor withdrawal


- MMF managers have started to bail out prime funds



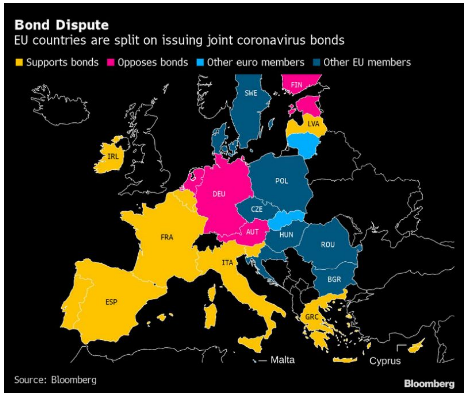
## ECB Pandemic Emergency Purchase Programme


- Negative interest up to $-1\%$
- €765bn ($\sim 60\%$) for banks to repay maturing ECB loans from previous QE
- €543bn ($\sim 40\%$) for banks to buy new government bonds → red bonds
- Highly profitable carry trade



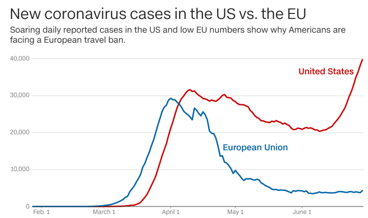
## Coronabonds

- Backed by all member states → low interest → blue bonds
- Joint responsibility → no incentive to reduce debt
- Suggest imposing country-specific limits to blue bond financing and financing the remaining debt using red bonds






## Global Economic Outlook




- ↑↑ Debt → 2 or 3 times GDP
- ↑↑ Unemployment → deflation
- ↑↑ Export pressures → trade tariff wars
- ↑↑ ESF resources → competitive currency devaluations
- ↑↑ Nationalisation of capital markets → yield curve controls