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Author: disoriented_llama
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If you are wondering the significance of RRP and its ramifications on the market, you are in the right place. This is not financial advice, and nothing contained here is to be considered a prediction.

0. Introduction

The point of this post is to explain how the RRP exploding is bad news for the market and the commercial banking system. I am going to assume you know the basics of how RRP works. I am going to take a deep dive into the plumbing of the banking system to illustrate how fucked the system really is, and how the Fed is trapped in the corner with no way out. I am not going to have a TL;DR, however I will try to make this as concise as possible for all our smooth brain friends. There are plenty of wrinkles to go around.

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Before we get started, there are a few basic things we need to understand:

1) The difference between monetary deflation and CPI deflation. When people use the words "inflation" or "deflation," they are typically referring to the CPI. However, for the purpose of this post I will be referring to *monetary deflation.* This simply means there are less dollars circulating in the economy. It is possible to have both monetary deflation and CPI inflation happen at the same time.

2) We have a debt based economy, which means that every dollar in existence has been loaned out. This can happen one of two ways- either a bank issues a loan, or the Fed buys bonds or other financial assets (this is what QE is). As loans get paid back, the dollars that are used to do so get *destroyed* from the economy (i.e. deflation).

3) Money you have deposited with a bank is a liability on the banks balance sheet. Simply put, it's not their money and you can theoretically withdraw it at any time. Banks are required to balance their books by holding assets.

4) If deflation occurs, debt becomes more expensive to service. This is obvious if you think about it, as dollars become more scarce and purchasing power of the dollar increases, it makes holding debt more expensive. **This is why the Fed needs inflation- to bail out the US government from their 28T+ debt burden.**

5) QE means Quantitative Easing. Is it a program the Fed runs to prop up the bond market and prevent interest rates from rising. This creates an "easy lending" environment in the economy thus encourages inflation.

1. Relationship between the Fed and the Commercial Banking System (CBS)

You can think of the Fed as a "bank for all the other banks." While the Fed does have the capacity to create bank reserves out of thin air, all they can do is put them into the banks reserve account. Those reserves don't enter the economy until they are loaned into existence. Think of "bank reserves" as lending capacity for the CBS.

1) Reserve accounts. The CBS has whats called a "reserve account" with the Fed. You can think of this as a checking account. Banks can only issue loans if they have money in their reserve account.

2) RRP account. This account is where banks park their money with the Fed in exchange for pristine collateral. Doing so **reduces their lending capacity** because they move money from their reserve accounts into this RRP account. (*Note, there is some nuance here pertaining to Money Market Funds, but it is not pertinent to this post so I will not speak on it)*

2. The US National Debt

[shit is crazy](https://preview.redd.it/laup8k86bgi71.jpg?width=417&format;=pjpg&auto;=webp&s;=509867a5d39f2ae8550569829f8a6ba1712847d3)

Most of us know how crazy the national debt is. Theoretically, the US could continue to increase their debt to infinity- although the issue is that you have to service past debt in order to do so. Eventually, the burden to service past debt becomes too great and you go insolvent. *Unless* you are buddy buddy with the Fed and they agree that it's in everyones best interest to not let that happen.

In essence, the Fed's #1 goal is to create inflation *so the US can pay back past debt with cheaper dollars.* Any hint of deflation and the Fed has to step in to disallow it lest they risk the entire global financial system collapsing due to US insolvency.

Now might be a good time to say that since the dollar is the word reserve currency, US bonds are the foundation of the entire global financial system. Now you understand why the Fed cares so much about inflation.

3. Banks Balance Sheet

Every bank deposit that you put in your bank has to be balanced by an asset of the bank. There are two main ways the bank can acquire assets: 1) **issue loans** or 2) **purchase a bond or other item to serve as collateral.**

Since '08, there has been a *massive* decrease in pristine collateral due to the financial crisis. If we consider that the standard way money enters the economy is by banks issuing loans, every dollar in existence should be balanced by an underlying loan.

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In this system, for inflation to occur there needs to be more loans going out that are being paid off. This typically happens as economies expand. **Since loans have cooled off in the past year or so, deflation has been happening in the CBS.** Since the Fed and the Government need inflation, they have to intervene. So what happens when you have months of lockdowns, your economy grinds to a halt, and people stop lending?

4. Stimmy Neutron

Many question whether or not the stimmys were meant to actually help the people or to bail out the government by combating the deflation happening in the CBS, but that is a debate for another day- the main point here is that **much of what went out in stimmys ended up in bank accounts.** As we noted above, this ended up as a liability for the banks balance sheet. **All of the sudden, things were no longer perfectly balanced.**

If the free market was allowed to be free, many banks would have failed because there simply isn't enough good collateral in the system to balance these books, and since the Fed is propping up the bond market with QE to avoid interest rates rising, bonds are more expensive as well. So to try and save the banks from collapse, the Fed is allowing the system to borrow the bonds they bought from their QE program. **THIS EFFECTIVELY TRANSFERS RISK FROM INDIVIDUAL BANKS TO THE ENTIRE FINANCIAL SYSTEM.**

5. RRP Feedback Loop

We already know that RRP usage reduces lending capacity due to banks moving reserves out of their reserve account and into the RRP account. Due to stimmys and people saving, **more liabilities are entering the CBS** while at the same time, loans are being paid off which **decrease CBS assets.**

This creates a feedback loop. Here are the steps:

1) Deflation occurs naturally over time due to more loans being paid off then are issued

2) Increased need for collateral as their assets shrink

3) Increased need to utilize RRP

4) Using RRP decreases lending capacity

5) Repeat step 1

The only way out is for the US to issue more collateral into the market. It just so happens that we are at our debt ceiling and Congress is on recess. Whether or not this is all manufactured and intentional isn't for me to discuss, the main point is that unless more collateral enters the market, the CBS is fucked.

6. Hyperinflation or Deflationary Death Spiral? A Crossroads

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It is clear that the Feds intervention into the "free" market is not working as intended- people are saving, not taking on new loans, and it's crippling the CBS. As this situation drags on, it creates more and more deflationary pressure, which requires more and more intervention in order to prevent deflation and the possibility of the US becoming insolvent. If allowed to run its course, the market will explosively correct itself as deflation causes massive amounts of debt deleveraging. Bond prices will plummet, sending interest rates to the moon. The US will no longer be able to service its debt and this would cripple the world economy worse than any other financial crisis in history. With hyperinflation knocking on the door, there seems to be no way out- UNLESS...

7. GME Bails Out the World

The Great Reset ***on ape terms.*** We all know that the Government wants its tendies. There is no good monetary reason for the government or Fed to step in and stop this rocket- because by letting it play out, GME will *single handedly wipe out the national debt.* This means that the Fed would no longer have to worry about inflation, take their foot off the gas, and let the deflationary death spiral rip through the world like a forest fire. Bad debt would be eviscerated, banks would default, it would be a depression like none other- only this time we have apes who will actually Build Back Better.

Power to the Players