A $350 Trillion Financial Empire Will Fall in 2021

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Of my graduating year, all hoped for banking jobs. Only two got them.

2009 was a rough year to apply for internships, let alone jobs. Those who did get internships weren't so sure about wanting to work at a bank any more.

But the world's obsession with banking continues nonetheless. Perhaps rightly so. If you examine the richest people in history and separate out the kings and emperors, you're left with bankers. Namely the Medici and their replacement, the Fuggers, who originally spelt their names with "ck" instead of "gg". The word apparently means sheep shearer in German…

With debt levels around the world at astronomical heights in every sector, bankers are doing rather well. Except for the shemozzle of 2008, they've had a remarkable run. **The finance sector dominates stockmarkets**.

Given all this **leverage**, how much of our modern-day prosperity is owed to banking? And is it real prosperity, or faux?

No matter how you see the world of numbers, our real-world prosperity is at remarkable levels. People with no income, no jobs and no assets were able to buy some pretty decent housing thanks to banking. That's better than magic.

But where to from here for banking? What does the future hold?

The bonanza of banking is under threat

Technology, an overindebted economy and government, and the exhaustion of monetary policy mean banking is under threat from all sides.

Interest rates can hardly go lower to enable even more borrowing. More money can always be printed, but if it isn't flowing then bankers are left without lending regardless. That's why German banks are storing billions of euros in cash in their vaults.

Perhaps the lack of lending comes from the extraordinary levels of debt the world is in already. More on that in a moment thanks to some new analysis on Europe's corporate sector. But first, what can we make of technology?

The monster hiding in the basement

It will be the IT department's ultimate revenge. After being cooped up in windowless basements for decades they'll soon replace everyone in the floors above them. There won't be any other bank employees by the time they're finished.

A vast amount of banks' costs are back office. Verification, record-keeping and many other activities that can be automated already. If all these jobs are eliminated, that could leave banks vastly more profitable. But it's not just the back office.

In Sweden, they're testing the automation concept in customer service rather dramatically. One of the major banks is installing a virtual customer-service representative called Aida to replace bank branches. Other Scandinavian banks already have Nova and Nina to digitally help their customers. The virtual customer-service representatives can supposedly meet all your branch banking needs. So why have branches? Banks won't, eliminating another major cost.

Tech could destroy banking's biggest costs, making them extraordinarily profitable quite suddenly. The question is whether the new tech will also destroy banks themselves. Because with **cryptocurrencies we won't need banks** at all.

Almost the entire banking process is cut out by cryptocurrencies. Only lending remains. Transactions, verification and keeping deposits safe is all inherently done by cryptos, depending on how you use them. The problem is that only one person can own a cryptocurrency unit at a time. This makes fractional reserve banking impossible, making modern banking impossible. Banks will be obsolete.

That's another reason to get out of the banking system and into cryptocurrencies now. My friend Sam Volkering has the best guide on how.

Among the victims of technology's progress is a surprising one.

The end of Libor's $350 trillion dominance

In 2021, the Libor rate will cease to exist. A remarkable 36-year history will come to an end. And US$350 trillion dollars' worth of financial products are already looking for a new interest rate to guide them. Answers are not yet forthcoming.

Libor is the reference rate for mortgages, credit cards and all sorts of exotic financial instruments you can imagine. But what is it? The London Interbank Offer Rate is actually a variety of different interest rates, but they all reference the cost of borrowing and lending between banks. Because Libor represents the bank's cost of funds, and banks finance the rest of us, it's the most basic interest rate.

But after a series of scandals involving the manipulation of Libor, banks are no longer interested in participating in the rather antiquated Libor process. One UBS banker was jailed for 11 years thanks to his machinations.

These days the markets determining Libor are losing importance. In 2016, one market which influences the Libor setting process only saw 15 transactions for the whole year. There are plenty of other more active rates that financial products could reference. But just what rate $350 trillion in financial products will be referencing in the end remains unclear. The decision has vast consequences for anyone in debt.

For now though, Libor remains as a token effort of cooperation between banks and regulators. In Hong Kong, the local version of Libor spiked overnight to rates not seen since 2008. That suggests trouble in the Hong Kong banking system, or a very inefficient Libor market there. Either way, changes are afoot.

Banking on Brexit

Brexit and banking are a journalist's match made in heaven. The two issues are so intertwined you can spin the story any which way you like. One side says Britain's finance sector will finally be unleashed. The other claims the loss of being Europe's financial centre will destroy the city.

Consultants Oliver Wyman released a report claiming **Brexit** will cost the banking sector a 4% increase in costs and a 30% increase in capital requirements. While Remainers shout "told you so", a closer examination shows that it's EU nincompoopery which actually triggers the costs.

After all, moving your business to a jurisdiction that favours things like transaction taxes, requires a major physical presence to do banking business, and doesn't deal with bad debt is going to be expensive. Not to mention financing all those bailout funds and bureaucracies. The costs of Brexit are not related to Britain, but to doing business in the EU.

And that explains why Oliver Wyman predicted that Brexit might trigger banks to abandon European activities altogether, instead focusing elsewhere. Like for example Britain, perhaps?

Being a banker in Europe must be worse than being a banker in London under the shadow of Brexit. Italy's non-performing loans, Greece's permanent depression and Scandinavia's automation of everything are bearing down on Europe. But there are even worse signs.

Europe's banking system teeters

The EU is considering new rules to prevent a bank run in the wake of runs on Spanish and Italian banks. Sounds good until you realise just how they plan to do it – by banning withdrawals. Initially, customers would be unable to withdraw their money for five days, but up to 20 days in extreme circumstances.

Of course this will only make bank runs more likely by incentivising them earlier at a lower threshold of risk. But the irony here is priceless because the media has been ridiculing a bitcoin exchange's similar policy, **pointing out how dangerous it is**.

The Financial Times' Alphaville highlighted that withdrawals from Cryptopay would be stopped as the system figures out the bitcoin fork. "Because in the real world shutting off access to funds for an indefinite period of time is a totally viable option for the banking industry!" Now it's potential EU wide policy! Cryptopay gave its customers plenty of warning, unlike the EU plans to do for bank customers.

But the EU's plan might be a good policy given the state of the banks' customers. In Europe, the corporate sector relies on banks for financing. Bank of America is reporting that 9% of Stoxx Europe 600 firms are at risk of defaulting on their loans. Their interest coverage ratios are below 1, meaning they couldn't cover interest expense with their profits.

And that's in a world where the European Central Bank is suppressing interest rates. Imagine if they rose. Banks and bond holders could be in serious trouble, and fast. Cue the bank runs.

But it’s not just Europe

The Bank of International Settlements puts the same figure at 10.5% for publicly-listed companies more than ten years old in 13 advanced economies. That’s almost double the per cent before the 2008 crisis, when rates were far higher.

In a world where debt dominates everything, paying attention to the banking sector is a priority. And the signs are not good. It’s time to get out.

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