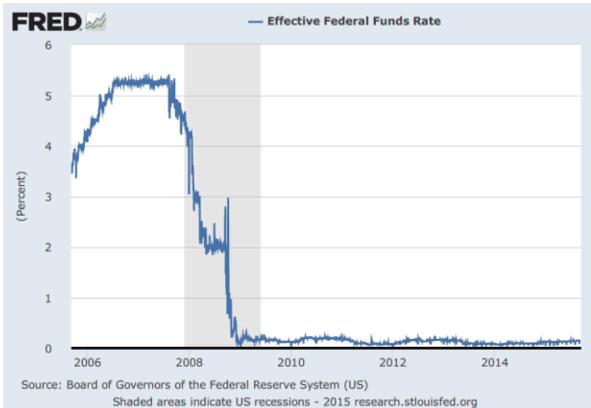
**The zero interest rate policy (ZIRP) harvest ahead of Fed rate decision** **September 12, 2015**
**10-year Treasury: 2.19%; S&P 500: 1961.05; Oil: $44.63; Gold: $1,103; Silver: $14.58 (9/11 quotes)**

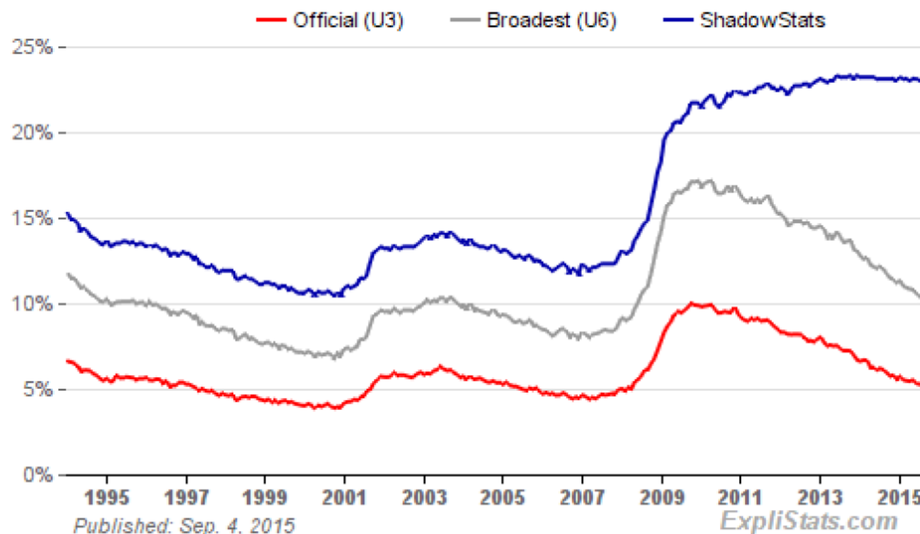


**Will the Fed raise the Fed Funds rate at its next policy meeting on September 16 - 17?**
The world's financial eyes, the talking heads at mainstream financial news outlets, and pundits a plenty continue to chime in on whether the Fed dare inch up its key overnight interest rate (effectively what leading banks charge each other for loans) after an unprecedented zero interest rate policy since 2008.

**The ZIRP (zero interest rate policy) Main Street dud:**
The recently disseminated August jobs report had some not-so-good news, but at least job growth still showed "a pulse;" 173,000 jobs were created in August versus an estimate of 220,000.

Meanwhile, and in contrast, the civilian labor participation rate continued to fall (please see chart on right above) which, together with a record 93m plus Americans not in the labor force, makes a mockery of a "5.1% unemployment rate."

If the more encompassing unemployment rate was still tabulated by the BLS (Bureau of Labor Statistics) to include long-term discouraged workers, as was the case until 1994, unemployment in the US would easily exceed 20%:

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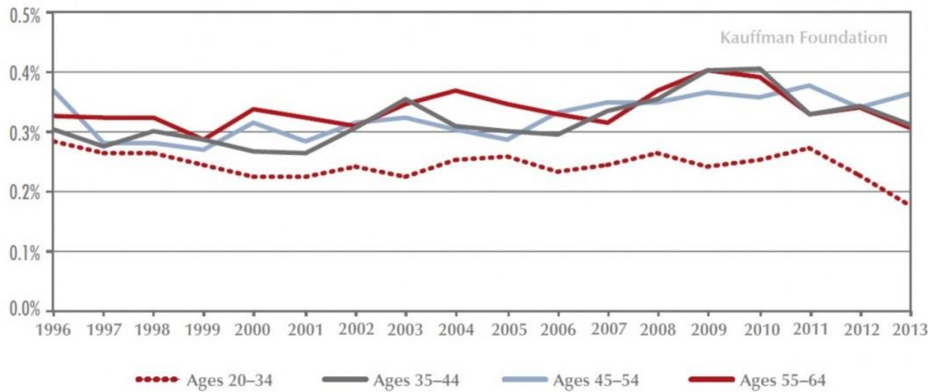
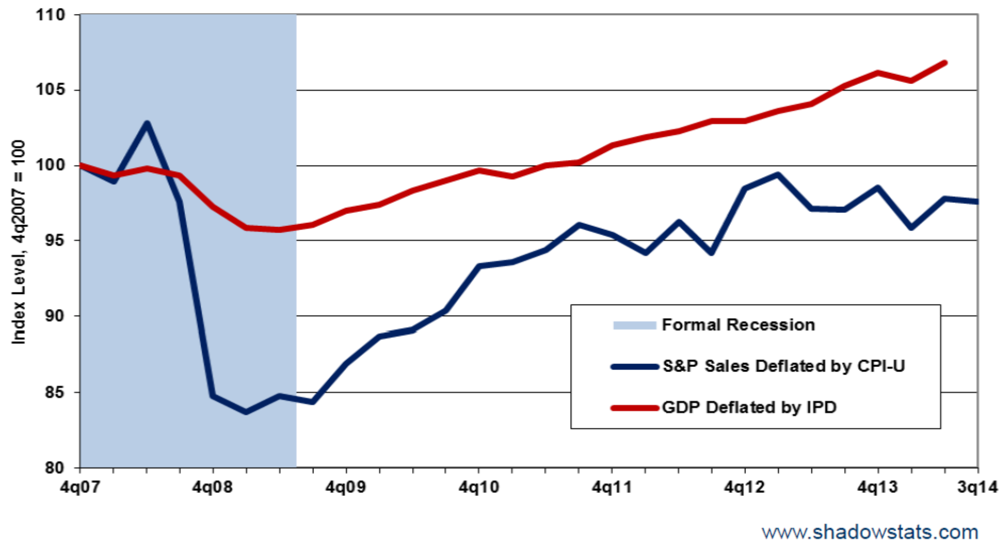
Clearly, ZIRP hasn't reached Main Street, where new business formation and job formation remain soggy:




And it hasn't bestowed a spike to Corporate America's inflation-adjusted top line since Q4:2007, which has lagged real GDP growth over the same period! So much for the rationale of ZIRP-based Keynesian demand stimulation:




**The ZIRP Wall Street bonanza:**

So just what has the Fed's and other leading central banks' ZIRPs, which are typically combined with QE -- also known as financial repression -- wrought? They have pumped up Wall Street's and London's bottom lines and especially compensation. Financial repression has also fostered huge asset bubbles, especially in government bond markets; in Europe, thanks to the ECB's 2015 launch of a massive $70bn monthly QE campaign heaped on top of its near ZIRP (a 0.05% benchmark "refinancing rate"), creditors became acquainted with the "distinct pleasure" of paying select governments for the privilege of lending them their money!

Increasing global financial repression has also enabled reckless expansion of deficit-based governmental operations; global government debt has been compounding at 9.3% since Q4:07, well above nominal GDP growth over same period:

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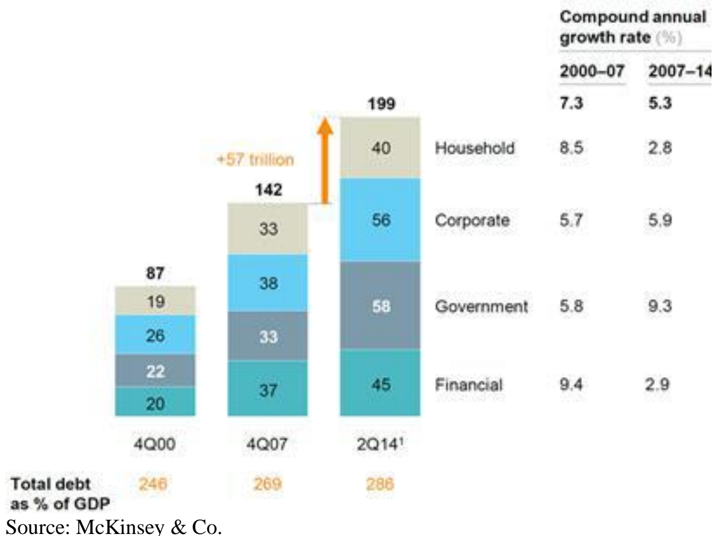

Source: McKinsey & Co.

In short, access to funding and the cost of funding, which are best determined by market participants (speculators and investors) based on risk and return assessments, have in essence been hijacked by central planners at the world's central banks. The results are "back in the USSR" predictable in terms of engendering growing sovereign solvency risks, rampant statist misallocations, swelling cronyism and, of course, falling productivity.

The $57trn increase in global debt since 2007 has not only led to unequalled Post WWII global debt to GDP levels, but it has also been accompanied by an unsurpassed, typically off-balance sheet, and hugely interest rate-sensitive derivatives market. At last count, 80.2% of all outstanding OTC derivative contracts, or a whopping $505trn or some 6.5 times world GDP, were LIBOR-based interest rate contracts. The nominal value of these derivatives as of December 2014 exceeded the nominal value of the mortgage securities that threatened to shut down the global financial system in 2008 by a margin of 406:1. The nature of interest rate derivatives dictates that banks are betting on stable or falling interest rates. Commensurately, money center banks' -- and the financial industry as such -- exposure to a return to historically more normal interest rates ("Between 1285 and the mid- 1600s, yields on government bonds fluctuated between 6% and 10% and in some cases were around 20% … Since the mid-1600s, the average yield on government bonds has been around 4%" -- James Dale Davidson, Strategic Investment, January 2014) could be expressed in liabilities/losses in the hundreds of billions, if not trillions, of dollars. Needless to say, higher interest rates would "bankrupt the banks and the central banks," and thus could well constitute the supernova that would likely herald the death of the current fiat money system.

In light of "all that" and much more leveraged economies (just a 1% higher debt financing rate in the US would raise the federal government's operating deficit by $180bn p.a.), does anyone seriously think that central banks are going to actively pursue higher interest rates at the short end that they directly control? More to the point, the global central bank leader, the Fed, is a privately held entity whose prime corporate directive is to assure the health and wealth of its (fractional reserve) member banks. The Fed's claimed dual directive -- full employment and price stability -- is but a public policy fig leaf. Just look at the trajectory of the civilian labor participation rate or consider the fact that since the Fed's incorporation in 1913, the dollar has lost 95.9% of its purchasing power. Even more telling: since the dollar gold standard was nixed by Nixon in 1971, the dollar has lost 83% of its purchasing power (in 2015, $5.89 is required to purchase what $1 bought in 1971). And don't forget: the government's inflation tallies are about as representative of reality as its unemployment rate statistics.

**Fracking and the long shadow financial repression has cast; the good, the bad, and the ugly:**
We would be remiss if we didn't include the economic and financial impact of the increasingly enfeebled US fracking (shale oil and gas) industry on the Fed's upcoming monetary policy decisions. Fracking, *as an industry*, never achieved a profit even with oil around $100 a barrel for nearly half a decade as it blasted oil out of rocks using copious

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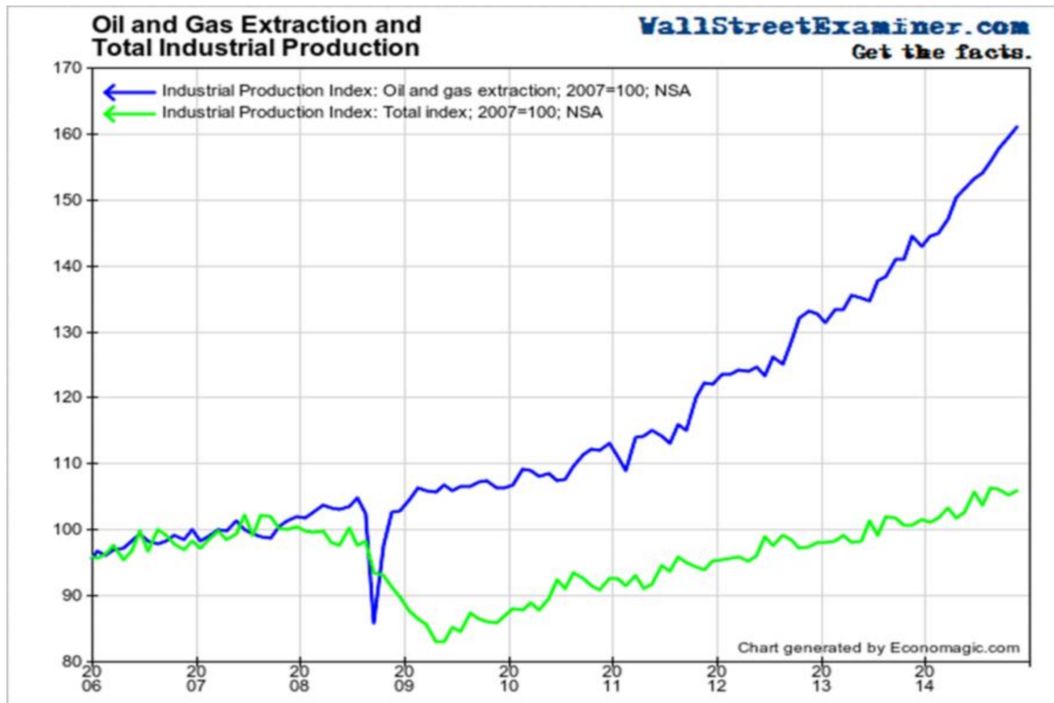
amounts of water, sand, and chemicals -- as well as tons of trucks and equipment to get the job done. Over the same period, the industry generated the vast majority of an astounding additional 3.7m barrels per day of US crude oil extraction, added a whopping $1.2trn to annual US GDP, and created an impressive 9.3m new high-paying American jobs. Fracking-centric employment growth in the oil & gas sector since '08 was over 40% through Q3:14 even as full-time payrolls in the rest of the US economy declined by about 3%. In other words, only thanks to the huge lift from fracking did the otherwise anemic US industrial economy manage nominal production growth:




Needless to say, with oil below $50 per WTI barrel, the fracking industry is now consolidating under even bigger operating losses associated with sharply lower oil prices. Both losses and consolidation/bankruptcies are set to accelerate markedly on the back of oil hedge (futures contracts at much higher oil prices) expirations and a shift from ample financing once eagerly supplied by yield-starved investors (thanks to financial repression) to investor avoidance of the industry.

Because the frackers were able to get over $500bn in funds, mainly in the form of debt, to finance their very capital intensive oil and gas extraction frenzy, there is a huge capital loss prospect facing both bondholders and investment banks. It thus stands to reason that this could, at least selectively, jeopardize pension fund financing adequacy (huge CALPERS will allegedly have issues) as well as pivotal money center bank balance sheets. To add insult to write-down/write-off injury, the flagging US industrial economy will now face a fracking headwind instead of a fracking tailwind. A one-two financial and industrial/economic punch of such magnitude doesn't speak volumes about a sustained rise in short-term (Fed Funds rate-based) interest rates.

**Conclusion:**

The financial repression casino must go on! Our global house of cards consisting of rising debt mountains, productivity-withering misallocations, unfathomable derivative-based, LIBOR-sensitive black swans in the wings, and sustained property rights (incentive) evisceration can't handle higher interest rates. Barring a "debt jubilee" followed by a return to stout rule of law (including regulatory and tax sanity) adherence, our fiat money, fiat government cocktail must be sustained. This is all the more true as the world's leading central banks already have zero interest rate policies in place. Upshot: any Fed rate hike will be a one-time, mini step. A one trick pony. A short-lived "flash in the pan." Central bankers the world over dare not rock the low short-term interest rate boat or unduly disturb asset bubbles, most especially not the pivotal/all-important government bond market, which if pricked

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could unleash a derivative liability daisy chain nightmare. Look for sustained ZIRP or near ZIRP the world over and more bouts of overt QE from various corners of the world; a Fed announcement here is overdue, in our view. In other words, look for fiat money to be further trashed, and allocate/invest accordingly.

Greetings,
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