Creating A Trillion From Thin Air

Overview

The Federal Reserve reported a $45 billion profit for 2009, making it the most profitable financial institution in the nation. Many news outlets put a positive spin on this report, saying it was great news for the economy and the financial sector. Are they right about that? Or could the full story of what happened represent a direct threat to the value of your savings and your retirement investments? Let's take a short look at the story behind the headlines, and the personal implications for you and your family.

As we all know, the large banks were in deep trouble in 2008 and 2009. The subprime mortgages were the trigger, but the problems rapidly spread into other investments. Markets totaling trillions of dollars were in danger of collapsing because of a lack of buyers.

Enter the Federal Reserve. This next part of the story is where 99% of the country usually stops reading. Because the concepts and vocabulary get a little obscure. That's what Wall Street is counting on – you not finishing this short article *Because that's the perfect way to steal by the trillions – do it in plain sight, but in such a manner that the people are blind to what you're doing.* Keep reading, and let's shine a light on what has been done, and why you should be personally concerned.

Paying For The Hidden Bailout

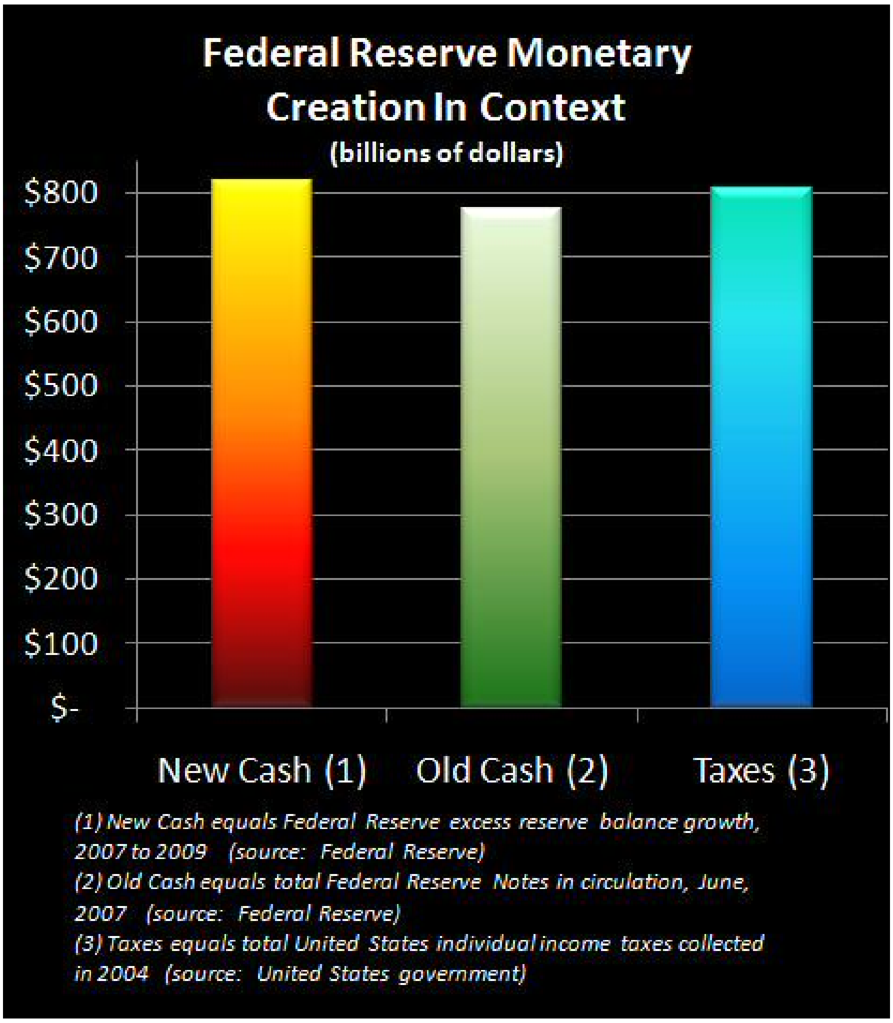
What the Federal Reserve did was to intervene in the troubled markets on a historically unprecedented scale. The Fed bought close to a trillion dollars of securities, at 100 cents on the dollar, meaning that it quite deliberately overpaid, and covered what the banks' losses would have been if they had sold into a free market. Except, the Fed didn't have a spare trillion lying around, and neither did the US government, or anyone else. Which raises the question: where did that money come from?

The Federal Reserve came up with $819 billion to pay for the securities (and manipulate the markets for the benefit of the large banks) by creating what are known as "excess reserve balances" and giving these balances to the banks in exchange for the troubled investments. "Excess reserve balances" is a terribly obscure term, but what it translates to is cash. Freely spendable cash that didn't exist before, but once it is created is every bit as good as the dollars in your wallet or your checking account.

That's what a central bank like the Federal Reserve does, and what separates it from any other bank or corporation – it can create money at will. Usually, this is done indirectly through controlling bank lending and capital requirements. However, in time of need, the Fed can directly create money out of nothingness, without limit. For good reason, this power is rarely used, as it tends to end up destroying the value of the currency and wiping out the value of everyone's savings. Yet, this power is being exercised right now on a historically unprecedented scale, with little media or political scrutiny.

New Monetary Creation In Perspective

The numbers are so large that they may lose meaning, so let's place this new money in perspective. Total physical cash in circulation – all the $1, $20, $100 bills and so forth – was $775 billion as of June 2007. By creating $819 billion in excess reserve balances, and handing it to Wall Street and the major banks, *the Fed directly created more new cash in less than two years than the total US physical cash in circulation after more than 230 years.* If we take into account that about half of US physical dollars are believed to be held overseas, the Fed created 2 dollars in new cash for every existing physical dollar actually in the United States. Now, only a minority of total cash takes physical form these days, most is just electronic digits on bank computers, but the comparison is illuminating nonetheless.



Here is some more perspective: total United States individual income taxes were $809 billion in 2004. In other words, *more money was spent to cash out Wall Street and major banks under highly favorable terms, than total annual individual income taxes collected just six years ago.* All without raising taxes or appearing in the Federal Budget. The real bailout for Wall Street never was what you saw in the headlines; it was what you didn't see that mattered.

These large numbers are perhaps still difficult to grasp, so let's make it personalAccording to the Census Bureau, there are approximately 111 million households in the United States. Divide $819 billion in new "excess reserve balances" by 111 million households, and that's $7,400 per household. In other words, your family's share of the new cash would have been enough to buy a used car.

Total Federal Reserve assets ballooned from $800 billion in 2007 to $2.1 trillion in assets today, an increase of $1.3 trillion. Effectively, this is another half trillion in new money on top of the $819 billion increase in "excess reserve balances", created through a variety of equally obscure mechanisms. When we move our per household comparison to the full $1.3 trillion increase in the Federal Reserve's balance sheet, that works out to about $12,000 per family. The car in the driveway that each of our families just "bought" goes from used to new, albeit a new subcompact.

If we add everything in, including the official government bailout, stimulus package and most importantly, the far larger Federal Reserve commitments to create new cash out of thin air in the future as needed, then total commitments to support Wall Street work out to $13 trillion, or $165,000 per household. Forget the car, this is enough money to buy a house! (The average cost of a house in the United States was $169,000 in the first quarter of 2009).

So, what the Federal Reserve commitments are effectively doing is placing enough money either currently into circulation (or committed to be in circulation if needed), to equal the value of a new home for every American household. Except of course the American households don't actually get those new homes. Instead, the money goes to the benefit of the large banks.

The Risks Of Creating Money For Wall Street

Now, here's the difference between the Federal Reserve bailout and the US Government bailout. You didn't pay a dime in taxes for the used car, the new car, or the Federal Reserve's share of the phantom house, nor were any new Treasury bonds issued to cover deficit spending. The new money just came into existence. However, the size of the economy didn't change. So if enough new cash has been created to buy every family in America a car – but there aren't any actual cars, just the new money, what happens to the value our savings and retirement investments? The clear risk is a precipitous plunge in the value of our money.

That's why the Federal Reserve hasn't used this free money system before, at least not anywhere on the current scale.Taxes take some of our money. *The government creating money in lieu of taxes takes the value of our money,*and has historically led to the destruction of the value of currencies when governments have taken these desperate measures in the past. There is no such thing as free money, and it is the nation's savers, and particularly retirement investors, who are bearing the risk of the hidden bailout of Wall Street.

There's another big difference between the official bailout, and the larger real bailout. The official bailout involved some losses, and loans to be repaid. The Federal Reserve bailout prevented the losses from occurring in the first place. So there were no losses, no reduction in bonuses and no loans to be repaid. There was just a simple transfer of risk on the troubled investments from Wall Street to us. With that transfer of investment risk being doubled by risking the value of all of our savings to fund the purchase with newly created cash. Twice the risk for you and I, with our taking both investment risk and inflation risk, and all the benefits of creating this artificial market quietly going to Wall Street bonus pools.

So if all this new money has been created, why hasn't inflation skyrocketed yet?Using the Federal Reserve Chairman's own speeches, we'll cover that in the next article, as we also take a closer look at the real source of the $45 billion 2009 Fed "profit". Here's the bottom line preview: we take even more risk, Wall Street gets even more rewards.

Taking Action

Consider two actions if you found this article to be of interest. Understand that what we've been discussing is effectively theft on the grandest of scales. In plain view but not understood or publicized. Circulate this article to friends and family, and consider writing your Congressman and your Senators.

The second approach is to not hold your breath waiting on real reform, but take personal action and take it soon. A collapse in the value of a currency necessarily forces a major redistribution of wealth, and the segment of the population that is most devastated by this seems to always be the same. It's the retirees, and the people close to retirement. When we look to past massive bouts of inflation in Germany, Argentina, and Russia – it is the pensioners who are impoverished more than any other group.

Thereis not an even cost that is being born by society as a whole, rather some segments are bearing much more of the burden than others. If your peer group (particularly Boomers and older) is headed for disproportionate financial devastation, then happenstance is unlikely to offer a personal way out. Instead, you must take quite deliberate actions to change your personal financial position so that wealth is redistributed to you, rather than away from you. The first step is education.

*Would you like to find practical solutions to the issues raised in this article? Find out how to position yourself to benefit from insider bailouts and reckless monetary creation? Do you want to know how to**Turn Inflation Into Wealth?** To position yourself so that inflation will redistribute real wealth to you, and the higher the rate of inflation – the more your after-inflation net worth grows? Do you know how to achieve these gains on a long-term and tax-advantaged basis? These are among the many topics covered in the free "Turning Inflation Into Wealth" Mini-Course. Starting simple, this course delivers a series of 10-15 minute readings, with each reading building on the knowledge and information contained in previous readings. More information on the course is available at DanielAmerman.com or InflationIntoWealth.com .*

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