

The modern banker as 'Typhoid Mary'. Discuss.

"Bear [Stearns] executives also believe the market for collateralised debt obligations, which is dormant, will eventually come back, though the instruments will probably have a new acronym to make them more palatable."

- The Financial Times, 14th February 2008.

According to [Wikipedia](#), Mary Mallon (a.k.a. 'Typhoid Mary') managed to infect 47 people during the course of her career as a cook. Three of them died of the disease. Between 1900 and 1907, she infected two dozen people with typhoid fever. She worked in Mamaroneck, New York for less than two weeks when residents began to succumb. She moved to Manhattan in 1901 and members of the family where she was employed started to develop fever and diarrhoea. The laundress died. She then went to work for a lawyer and managed to infect seven out of a household of eight. In 1906 she moved to Long Island. Within two weeks, six out of eleven household members were hospitalized. She changed employment again and managed to infect three more families. Her fame "is in part due to her vehement denial of her own role in causing the disease, together with her refusal to cease working".

Nobody, of course, suggests that modern banks are virulent and destructive plague carriers. They are a lot more dangerous than that. But there are more than a few commonalities: carriers of typhoid, like the originators and redistributors of securitised subprime mortgages, and other largely unpriceable repackaged debts, "continue to excrete the bacteria in their faeces.."; and, as with poor Mary Mallon, the sense of denial for their own responsibility is almost palpable.

Imagine a world without banks, suggests [this site](#). If there were no banks..

- Where would you go to borrow money ? (Banks no longer have a monopoly on supposed risk-taking, assuming they ever did, but the question forms a presumption that unlimited and indiscriminate access to credit is essential in a modern economy, rather than a sign of fiscal indiscipline and a general symptom of a dependency culture that perpetually postpones making tough decisions – like, for example, saving.)
- What would you then **do** with your savings ? (Invest them, perhaps, into either productive, wealth generative businesses that make things - rather than simply shuffling paper around in what amounts to financial *legerdemain* - or into comparatively safe 'plain vanilla' government or corporate securities, or perhaps even into the precious metals that represent 'traditional real money as a store of value' superior to the theoretically infinite and therefore ultimately worthless supply of fiat currency.)
- Would you be able to borrow / save as much as you need, when you need it, in a form that would be convenient for you ? (See responses to Questions 1 and 2. In the context of loans for property, there are still one or two holdouts known quaintly as 'building societies', but their own [misadventures](#) in SIVs, CDOs, Treasury assets, real estate loans, "fair value movements" and "hedge ineffectiveness" – a concept borrowed from Bear Stearns ? – suggests they are at least as capable of haemorrhaging capital as the best banks. And in our brave new web-enabled world, as [Zopa](#) now suggests, "People are better than Banks".)
- What risks might you face as a saver / borrower ?

At least we are now somewhat closer to appreciating the ironies inherent in Question 4. In a world **with** banks, risks to savers include: a confidence-draining run that threatens the loss of all savings beyond those guaranteed by a deposit insurance scheme with almost no underlying assets; a growing pyramid of unrestrained lending based on increasingly flimsy over-engineered financial structures that nobody either within the banking system or outside it can seem to understand or even price; a widespread infection of the credit markets that triggers in turn a crisis of confidence

between banking counterparties and between banks and investors, culminating in a debt deflation and an economic downturn of uncertain duration and severity. Thank goodness for the banks !

As somebody once said during the internet boom or perhaps earlier, banking is necessary, but banks aren't. There is no shortage of businesses with substantial capital that can perform broadly similar services, at least to those offered by so-called narrow banks. Banks may enjoy a privileged position in terms of credit creation, but money itself is completely fungible. One of the critical problems with our fractional reserve banking system is that banking institutions are performing so many more complex, risk-taking functions than merely accepting deposits and making loans (or these days, **not** making loans). When confidence in the system craters as a result of a tidal wave of credit infection and of doubts about undisclosed losses trapped opaquely and perhaps dishonestly within it, the system breaks down, and requires at the minimum substantial amounts of taxpayer capital just to allow it to tick over.

Bank executives await news of the latest quarterly profit warnings



One of the loudest broadsides launched against the banks was by Martin Wolf of the FT back in January:

"No industry has a comparable talent for privatising gains and socialising losses.. Yet the conflicts of interest created by large financial institutions are far harder to manage than in any other industry: First, these are virtually the only businesses able to devastate entire economies; second, in no other industry is uncertainty so pervasive; and, finally, in no other industry is it as hard for outsiders to judge the quality of decision-making, at least in the short run. This industry is, in consequence, exceptional in the extent of both regulation and subsidisation. Yet this combination can hardly be deemed a success. The present crisis in the world's most sophisticated (sic) financial system demonstrates that.. I now fear that the combination of the fragility of the financial system with the huge rewards it generates for insiders will destroy something even more important – the political legitimacy of the market economy itself – across the globe."

Mr. Wolf's Jeremiad was met in response by some rather self-serving special pleading from anonymous investment bankers in the blogosphere, but otherwise by much ongoing sympathy within the FT letters page (and here and elsewhere).

But why continue grimly to focus on the rancid open sore that is the banking system in 2008 ? The February 7th front page headline of the European Wall Street Journal provides much of the answer:

"UK's role as finance hub is now economic burden."

For what is the UK if not the world's largest offshore financial centre ? As the WSJ's Alistair MacDonald and Mark Whitehouse point out, "No large country is more dependent on the movement of foreign money through its banks: some \$2.4 trillion flowed in and out of the UK in 2006, an amount equivalent to the country's entire annual economic output.." The WSJ also suggests that, rather ominously, "**the financial sector accounts for more than one-fifth of all UK jobs**". The comparable figure from the US, which treated the world to the subprime debacle in the first place, is just 6%. And whatever damage a softening property market and stalling investment banking

business inflicts upon the economy may be reinforced by the government's on-the-hoof flip-flop policymaking-by-headline approach to non-domiciles.

The Bank of England's [February Inflation Report](#) was pulling few punches:

"The disruption to global financial and credit markets continued. Current and expected policy rates fell. Sterling depreciated substantially.. Consumer spending growth appeared to soften and the climate for investment deteriorated. International prospects worsened, especially in the United States.. the Committee's central projection is for output growth to slow markedly this year and then gradually start to recover. The risks to growth are weighted to the downside."

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Even that masterly use of central bankerly understatement gets the point across. Annoyingly for the Bank, inflationary expectations are on the rise. Admittedly, looking out further we can ignore the short term effects of higher energy, food and import prices, because they will be offset by falling house prices, rising unemployment and – theoretically at least – falling wages. But in the interim, increasing fears of stagflation warrant heightened exposure, in a debt market context, to inflation-protected debt **and nothing else**. And as [The Business Ledger](#) is probably correct to suggest, there is a growing danger of a bubble forming in government bonds. The only economic backdrop that justifiably supports 10 year UK government bond yields, for example, at or around 4.5% - just 40 basis points higher than the year-on-year rise in the Retail Price Index – is one of incipient Armageddon. The trouble with that thesis is that incipient Armageddon, or for that matter merely a perpetuation of the ongoing cretinocracy that is the banking sector, would argue for some colossal government (i.e. taxpayer) support for that same ailing banking sector. To put it politely, that would be diabolically negative for conventional bondholders, though altogether less problematic for inflation-protected investors. Absent tangible evidence of a recovery in housing and consumer spending (other than a few days' irrational exuberance on the part of equity investors), a poor outcome for banks – and, in turn, quite possibly for conventional Gilts, US Treasuries, et al – seems a feasible outcome. Tragically and ironically, a rapid **recovery** in housing and consumer spending might yet have exactly the same effect. Conventional government bonds are starting to look dangerously overbought.

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