How Commercial Banks Create Money from Nothing

Keys to Understanding a Commercial Bank's Money Creation Process

1. *When you deposit money in a bank it is no longer yours. It belongs to the bank. You own an IOU.* You are loaning the bank your money and becoming an unsecured creditor. To compensate you, the bank puts credits into your checking account hence the name checkbook money. Writing a check is an efficient way for the banks to transfer liabilities amongst themselves.
2. In order for a bank to make a "loan," a new deposit is needed, but not for the reason you think i.e., lending it out. The new deposit starts the "Reserve" process which allows banks to duplicate the amount of money deposited (less the Federal Reserve's reserve requirement) and call it the new name of "Excess Reserves." This new money created from nothing is what the borrower gets in a new "loan."
3. *From a banker's point of view money is not created out of thin air but taken out of the bank's excess reserves*. While this is true it is also true that the money used to make up the excess reserve is not the original deposit but rather money created from nothing. See "Fractional Reserve Banking Example"
4. Banker's use words to confuse people in two ways;
    a. Redefining common words into something useful to the bank and not telling the client of the change. See "How Bankers Corrupt the Word "Lend" to Deceive Borrowers into Paying Interest."
    b. Using the same word in different contexts e.g., the word "reserve" is used to mean the Federal Reserve's reserve requirement, the amount of money a bank has in its own "Bank Reserves," and the amount of money created for the "Excess Reserves."

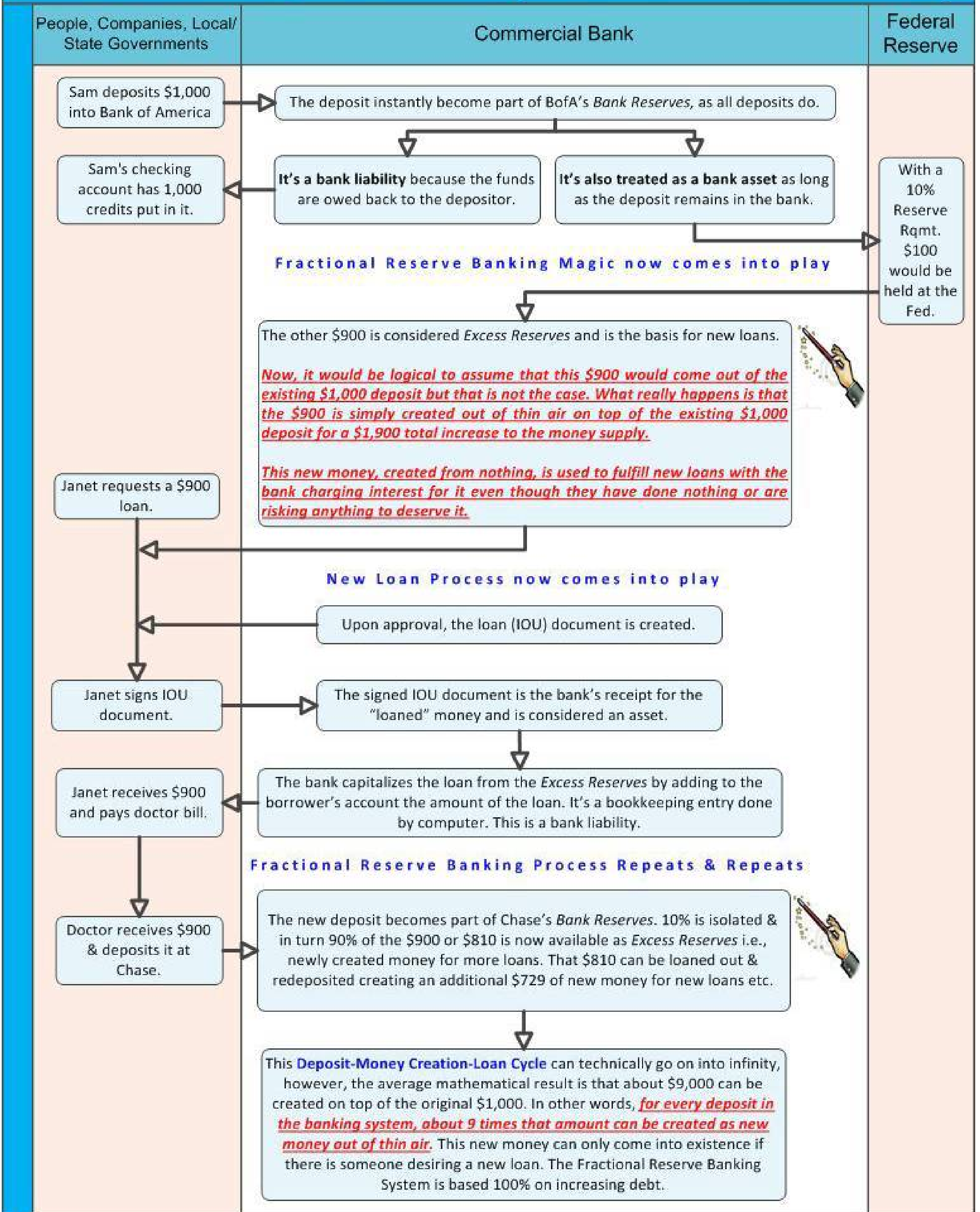

Figure 3 - Flowchart - How Commercial Banks Create Money from Nothing

Fractional Reserve Banking Example

Refer to Figure 3. In order for a bank to make new loans i.e., create new money, a new deposit must occur which then triggers the "Reserves" process. Let's assume Bank 1 receives a new deposit of $1,000 from Sam. The $1,000 deposit instantly becomes part of Bank 1's Reserves, as all deposits do.

	Amount Deposited	*Additional Bank Reserves*		*Expanded Money Supply*
Bank 1	$1,000	$1,000		$1,000

Using 10% as the Federal Reserve's reserve requirement, Bank 1 has to take $100 from their Bank Reserve and store it at the Federal Reserve. The other $900 is considered "Excess Reserves" and is the basis for new loans.

Now, it would be logical to assume that this $900 would come out of the existing $1,000 deposit but that is not the case. What really happens is that the $900 is simply created out of thin air on top of the existing $1,000 deposit for a $1,900 total increase to the money supply. In other words, the $900 can be created out of nothing, simply because there is demand for such a loan and there is a $1,000 deposit to satisfy the reserve requirements.

	Amount Deposited	*Minus 10% Reserves held at the Fed*	*Excess Reserves New $$ to Lend Out*	*Expanded Money Supply*
Bank 1	$1,000		(this is the money created from nothing)	$1,000
Bank 1	$1,000	$100	$900	$1,900

Now, let's assume Janet walks into Bank 1 and borrows the available $900 of Excess Reserves to pay a doctor bill. The doctor deposits it into his own bank account at Bank 2. The fractional reserve process then repeats. The new deposit becomes part of Bank 2's reserves, 10% is isolated and in turn 90% of the $900 or $810 is now available as newly created money for more loans. That $810 can be loaned out and re-deposited creating an additional $729 etc.

	Amount Deposited	*Minus 10% Reserves held at the Fed*	*Excess Reserves New $$ to Lend Out*	*Expanded Money Supply*
Bank 1	$1,000		(this is the money created from nothing)	$1,000
Bank 1	$1,000	$100	$900	$1,900
Bank 2	$900	$90	$810	$2,710
Bank 3	$810	$81	$729	$3,439
Bank 4	$729	$72.90	$656.10	$4,095.10
. . .	. . .	. . .	. . .	. . .
		$1,000	$9,000	$10,000

This **Deposit-Money Creation-Loan cycle** can technically go on to infinity, however, the average mathematical result is that about $9,000 can be created on top of the original $1,000. In other words, ***for every deposit in the banking system, about 9 times that amount can be created as new money out of thin air***. This new money can only come into existence if there is someone desiring a new loan. The fractional reserve banking system is based 100% on increasing debt.

How Bankers Corrupt the Word “Lend” to Deceive Borrowers into Paying Interest

Bankers had a problem. They wanted to make lots of loans, collecting lots of interest, but without risking their own money. Ideally they wanted to use their power to create money from nothing and let the borrower use this new currency. That way there would be no risk to the bank. The problem was how to get people to accept the idea of paying interest on money the banks created out of thin air. They didn’t want the public to know they weren’t using their own money. They feared the populace would question the bank charging interest when they weren’t actually lending any of their assets and taking no risk at all.

Their solution was to lie. Bankers decided to use the common word “lend[7]” and change its meaning in their contracts and not tell the borrowers. People would naturally assume bankers were using the word “lend” the same way the rest of the people on the planet use it. But that is not the case.

Banks use the word “lend” to make people think they should pay interest for using the bank’s assets when in fact; the bank has done nothing or risked anything to deserve interest payments.

Bankers unilaterally redefined the word “lend” to describe their bank process that;

1) Creates new money for the borrower to use rather than using any of the bank’s assets,
2) Creates new money from debt through accounting entries,
3) Requires borrowers to sign an IOU paying interest on newly created money - not the bank’s money,
4) Requires borrowers to forfeit their collateral should they not pay the interest on the newly created money.

Today, most people borrowing money from a bank assume it’s lending them part of its own money or that of the depositor’s. Instinctively they will think it fair to pay an interest charge for the privilege of using some of the bank’s assets. After all, no one else can use them if they are – right? Wrong - this assumption is at the heart of the deception. The bank is using absolutely none of its own money in capitalizing the loan but is charging interest for something that didn’t exist until the borrower signed the loan documents. This disinformation is vital to instill in the borrower’s mind a feeling of obligation. That is, getting the borrower to feel that it’s only fair to pay the bank something for the use of its assets. In point of fact, the bank isn’t using any of its assets. It is creating new ones. It is risking nothing, yet it charges interest as if it is.

Banks don’t lend anything – they just want you to think they do so they can charge interest.

Signing the bank’s lending agreement (IOU), provides the bank the legal authority needed through the bank’s charter to create new money by a bookkeeping entry. A computer enters the loan amount into the borrower’s deposit account and the money supply increases. That’s it – new money.

> ***“When a bank makes a loan, it simply adds to the borrower’s deposit account in the bank by the amount of the loan. The money is not taken from anyone else’s deposit; it was not previously paid in to the bank by anyone. It’s new money, created by the bank for the use of the borrower.”***
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> ***Robert B. Anderson, US Treasury Secretary 1959.***

[7] These arguments also apply to the banker’s use of the word “loan.”

Banking Facts Bankers Want to Stay Hidden

- Up until this point, banks have always dispensed cash when a depositor requests a withdrawal. We have been conditioned to believe we can go to our bank and get our money in cash anytime. However, legally that has never been the case.
- By law, a bank is not required to keep deposits available for our withdrawal.
- As of Dec 10, 2012, failing banks will be resolved with Bail-In procedures rather than Bail-Outs. A Bail-in is the legal authorization for Big Banks to confiscate their depositor's money without their permission or advanced warning. This most likely will happen overnight.
- In a Bail-In, the failing bank's depositors' money is used to recapitalize a new bank on the ashes of the old. Account balances are converted to equity (stock) in the new company and each depositor then becomes responsible for selling this new stock to get cash.
- The FDIC will not replace a depositor's money in a Bail-In scenario since it will no longer be responsible for confiscated deposits. Why? Because the FDIC only insures cash accounts not equity accounts.
- To create new debt (and bank profit), banks must continually "encourage" people, companies and governments (local, state, federal and other countries) to borrow more and more.
- The Great Secret of Banking is that banks create the money they "lend" simply by entering the "loan" amount into the deposit accounts of the borrower.
- For the trivial act of creating new money, banks charge interest having done absolutely nothing to deserve it[8].

Point to Ponder

> No matter where you earn the money, its origin was a bank and its ultimate destination is a bank. The loop through which it travels can be large or small, but the fact remains all interest is paid eventually by human effort. And the significance of that fact is even more startling than the assumption that not enough money is created to pay back the interest. It is that the total of this human effort ultimately is for the benefit of those who create fiat money. It is a form of modern serfdom in which the great mass of society works as indentured servants to a ruling class of financial nobility.[9]

[8] Author comment: ***The creation of money by banks is so incredibly simple most people just don't believe it.***
For over two years I have been asking people if they know how money is created and only one has answered correctly. This confusion is understandable since one of the banking industry's primary goals is to distract people from the reality of money creation. They befuddle people by adding a myriad of complicated ancillary finance issues so the essence of their money-making regimen is hidden. People accept the fallacy of paying interest because "it's always been that way," when in fact it hasn't. It only became common when the 1913 Federal Reserve Act was signed. This law created the privately owned US central bank called the Federal Reserve. In passing the law Congress "delegated" its Constitutional power to coin money to private banking concerns. The banking industry's program of misleading the public is so complete, the majority of Americans cannot even conceive of the possibility of no-interest loans. Public banks can do this.

[9] The Creature from Jekyll Island – A Second Look at the Federal Reserve, by G. Edward Griffin, published by American Media, copyright 2010, 5th Edition, p.192.