

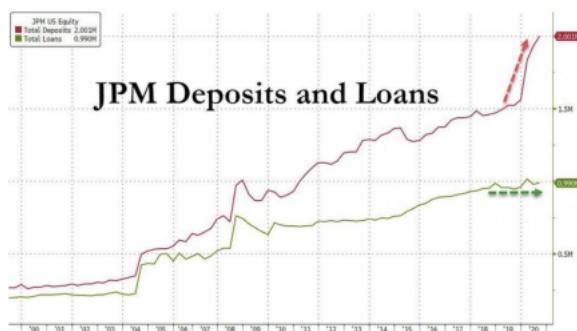
Funding the Future

Article URL

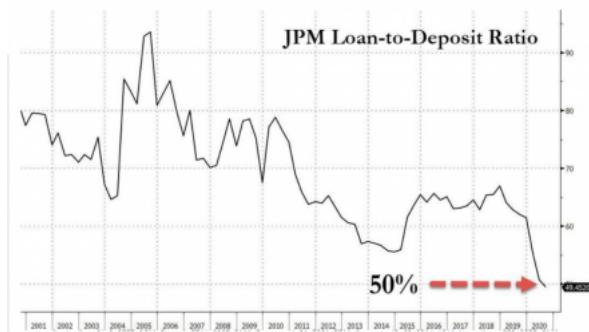
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My attention has been drawn to the [Zero Hedge](#) website where this has been posted:

There was a remarkable disclosure in the latest JPMorgan earnings report: the company reported that in Q3, its average deposits rose by a whopping 30% Y/Y, and up 5% from Q2, to just over \$2 trillion, even as the average amount of loans issued by the bank were virtually unchanged Y/Y at \$991 billion, and down 4% from Q2.



In other words, for the first time in its history, JPM had 100% more deposits than loans, or inversely, the ratio of loans to deposits dropped below 50% for the first time ever:



The conclusion of the piece was:

We will update this analysis tomorrow once we have the full bank data, however the take home message for now is that the next time someone says that under fractional reserve banking deposits are always a consequence of loan creation – one of the core pillar of [such idiotic theories as MMT](#) – just show them the chart above.

I was asked to comment on this. I have three comments to make.

First, there is no such thing as fractional reserve banking anymore. Even the [Bank of England says that is history](#). So, the whole basis for this post is wrong.

Second, Zero Hedge appear to be unaware that the quantitative easing process has the effect of creating new bank deposits which are then held with a central bank. This is not by accident. This is by design. And those deposits are not made within the commercial banking system by way of commercial banking loan, because this is central-bank money, and not commercial bank money, and the two are not the same.

Third, that central-bank money is created by loan, just like all of the money is created in that way, but the loan arrangement is entirely within government-controlled functions. This is what differentiates it from commercial bank-created money. Commercial banks can only create money by lending to third parties. Government can do it by lending to itself. In the UK that is done by government / Bank of England interaction. In the US, substitute the Fed, but the outcome is the same.

Given these three facts, what Zero Hedge reveals is that it has no comprehension of the way in which the banking sector, or quantitative easing processes, work. It's quite scary that such ignorance still exists.

Perhaps more importantly, it also reveals that it is entirely unaware of the difference between commercial bank-created money and government-created money.

Less surprising is the fact that it has not thought about whether, given that such a difference exists, it is appropriate for deposits held by commercial banks with their central bank should be shown as deposits on their balance sheets, or as something quite different.

I do not wish to be presumptuous here since this is an issue that I am currently working on. However, it seems to me that some fundamental accounting errors are now being made with regard to such issues. That error is partly in government accounting. There central reserve accounts maintained by the commercial banking sector with the central bank are shown as liabilities. However, in practice those commercial banks have no control over the redemption of these deposits, which can only be moved between those banks, but not ever, in effect, be reclaimed by them at their option, meaning that they do not behave like any normal bank liability. In that case, as they are effectively not repayable, are they liabilities at all? And in that case do these accounts need to be differentiated in the accounts of those commercial entities as being something fundamentally different from bank deposits?

I will return to this theme, but suffice to say for now that I think that significant new thinking on this issue was required.