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HOW BANKS INVENT MONEY

Around 90 % of the money in the whole wide world doesn't actually exist and it makes perfect sense and by the end of this video it will make perfect sense to you as well. You see, the entire global economy runs on credit. Because it would be literally impossible to build cities, fund companies and run governments using only the money people already have. So this is how credit actually works, why most money isn't actually real and how the rich use cheap money while everyone else gets stuck paying for expensive money. Welcome to Alux, the place where future billionaires come to get inspired. According to estimates, the world is around 300 trillion dollars in debt, but to whom do we owe all of this money to? Aliens? You've probably heard someone say that trying to sound clever before, usually the same guy who's a little too much into Rick and Morty. It's also a sign that they're a wubba lubba dub dub ass and don't know the first thing about economics. So if I lend you $100, you lend that same $100 to Jimmy and Jimmy lends it back to me. Our little friend group still only has $100 in cash, but now we've created $300 in debt. No new money

entered that system, just 3 promises stacked on top of each other. Extrapolate this idea to the entire world and that's how we get a 300 trillion dollar debt, while only a fraction of that actually exists in actual cash. But there is one difference, we all get to spend that money without actually having it. This is the foundation of a credit-based economy. That means most of what we call money is actually just numbers on a screen. And technically speaking, there's no limit to how much digital money can be created as long as the system trusts that it will be paid back. That trust is what makes the whole thing work. As long as we collectively believe that debts will be repaid, that debt can keep growing and so can the economy. That's why if you go to the bank right now and ask for a loan, the banker doesn't say, sorry, Jimmy already borrowed today, we're all out. If the bank believes that you're good for it, they'll approve the loan and new money is created into your account out of thin air. That money only becomes real, physical cash if you decide to withdraw it. That's when the bank actually has to open up the vault and hand you paper bills. But here's the part that most people don't realize. Banks have decades of data showing that, on average, only about 10 % of all money is ever withdrawn as physical cash

at any time. So they don't keep 100 % in reserve, they don't need to. They only keep around 10 % of total deposits in actual cash, sometimes even less. Let's take the US as an example. There's about 21 trillion dollars in broad money supply, but only around 5.5 trillion dollars exists as physical cash. Everything else is just numbers on a screen. So what happens if everyone decides to withdraw their money all at once? Total collapse. The system implodes. The banks run out of cash in hours. Which is why we all kind of agreed to not do that. It's like a sort of economic pinky promise. And as long as that promise holds, the banks can keep creating money, the economy keeps moving and most people never even notice the illusion that their money isn't real. When you check your banking app, swipe your card or make a wire transfer, you're moving promises. Not physical money. And as long as no one breaks the chain, the illusion works. And you know, this is the stuff that so many people never actually learn or understand, which is why we created the ALUX app. It's essentially a tool for you to gain all of the knowledge you need to build, grow and sustain your wealth. And you can get 25 % off your membership if you download the app and scan this QR code on screen. We're not just shipping promises

in there, we're delivering something actionable. But let's get back to how all this credit business works, shall we? WHERE CREDIT COMES FROM So banks, they don't hand out money they already have. They create new money based on the promise to repay it. What they give you is a digital entry, a deposit that becomes real only because the bank says so and because the economy agrees to treat it as spendable. Every time someone takes out a loan, the bank creates new money by literally typing it into your account. So say you take out a loan for $200 ,000 to buy a house. They check your credit score, your income, your debt load and calculate how risky you are to lend to. That is how they determine whether you get cheap money or expensive money, also known as your interest rate. You sign the paperwork, the bank hits approve, and just like that $200 ,000 appears in the seller's account. What the bank just did is take your future income, convert it into a digital promise and inject it into the present as spendable currency. This is how banks expand the money supply. This expansion happens in what economists call the M1 and M2 money supply, which includes your checking account, savings and other liquid assets. When banks create loans, they're inflating this

broader money supply. This process is made possible by a system called Fractional Reserve Banking. Banks are only required to keep a fraction of their deposit base as physical cash or essential bank reserves. The rest can be loaned out, multiplied and circulated. So if you deposit $1 ,000, the bank might keep $100 on hand and lend out the other $900, which then becomes another deposit, creating a ripple effect of new money. And in many modern economies, that fraction is now 0%. In the US, for example, the Federal Reserve eliminated all reserve requirements in March 2020 to handle the COVID pandemic. That means US banks no longer need to hold ANY cash in reserve to issue loans. They can lend out as much money as they want as long as the borrower is considered creditworthy and the bank meets its capital ratio obligations. So when you hear about printing money, what it actually means is typing it out digitally. And this system also creates cheap money and expensive money. The real sign that somebody is wealthy is not how much money they have, but how cheaply they can borrow lots of it. The better your credit score is, meaning your history of paying back debt, your income, your assets, your perceived risk, the lower the interest rate you'll be offered. And that

interest rate is the cost of money. If your credit is good, you might be able to borrow, let's say, 3%. If your credit is bad, you're stuck with 15-25 % or you might even not get approved. And here's why having access to cheap money is extremely lucrative. Once you borrow cheaply, a new, powerful concept becomes available to you. Credit Arbitrage. You borrow at one rate, invest at a higher rate and pocket the difference. So let's say you don't know anything about finance, you're not running a hedge fund, you just want to play the game a little bit in the most basic way possible. So you take something like the S &P 500, a stock index made up of 500 of the largest US companies. Over the past 10 years, this index has returned an average of 10.3 % annually. So that means that even a lazy investor who buys and holds the index, with zero timing and research, would have made 10 % a year. So if you borrow at 3 % interest rate and invest in the S &P 500, you're making free money, the system rewards you just for having access to cheap money. That is a credit arbitrage. If you watched our Buy, Borrow, Die video, this is part of the reason why that strategy is so profitable. Rich people have done this for decades. In fact, entire nations have done this. And sometimes, they paid the price. In

the 1980s, Japan's economy was booming, interest rates were low and the yen was stable. So Japanese investors started borrowing money at home and investing it abroad, particularly in the US assets that had higher returns. This became known as the carry trade, borrowing cheap yen, converting it to dollars and investing in higher-yield foreign securities. It worked incredibly well… until it didn't. By the early 1990s, Japan had a wildly overvalued real estate market, a bloated stock market and a debt-fueled economy built on leverage. When asset prices crashed, the entire system collapsed. The fallout was so severe that Japan entered what's now called the lost decade, a 10-plus year economic stagnation that Japan still hasn't fully escaped. Cheap money is not inherently bad or anything, but when it fuels speculation instead of productivity, it becomes a ticking time bomb. You see, as long as people don't all demand cash all at once, and they actually pay back the loans, everything runs smoothly. At first glance, this might look like a shaky system that runs just on pinky promises and trusts amongst each other. But essentially, this is what makes development possible. If a country would have to save up money to build a new infrastructure, for example, it would probably take

decades, everything would come to a halt. It's not a perfect system, but so far, it's the most efficient way we've found to scale human productivity using money we don't have yet. Until somebody comes up with a better way of doing things, this is what we've got, and it works for the most part. Thanks for spending some time with us today Aluxer, we hope you found this one valuable. We'll see you back here next time. Until then, take care.