



## Dr. Pippa Malmgren: CryptoCurrencies – libertarian dream come true or Orwellian nightmare? July 20, 2017

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**Erik:** Joining me next on the program is Dr. Pippa Malmgren, founder of DRPM Group, and colloquially known to the Macrovoices team as the goddess of all things geopolitical pertaining to markets. So Pippa, thanks so much for coming back on the program. It is great to have you. We had your dad on the program. I want to mention to our listeners. If you didn't listen to that one, you and your dad's interview together was fantastic. Between the two of you, I think you have advised more U.S. presidents than anyone else I can think of. Just the background and experience that you bring to the table, it was really great. I am really looking forward to this interview as well. Let's start with Europe. We have heard from Grant Williams the end is nigh, and Brexit was the event, the catalyst that's going to bring about the complete demise of the European Union over time. It seemed for a while that Europe was falling apart at the seams, and then Macron won the French election. The Euro is rallying. A lot of people say it is all better now. What is the real story? What is your outlook for the European Union both short, medium and long term?

**Pippa:** I love Grant Williams, so I am very reluctant to cut across him. But I am on the other side of the trade. Europe has big structural problems in the longer run, but in the short run what they have had is a little bit of growth. I think everything is attributing the Macron win to a more settled environment, but really what happened was we got a little bit of growth. We are getting a tiny bit of inflation, and so the markets are a little bit more optimistic. Also, there are a lot of people still trying to figure out does Brexit make Europe stronger or weaker. The argument that it makes them stronger because they lose this break, this country that's constantly been a pain and not onboard, now they are not there anymore, so Europe can proceed in its Federalist direction much faster and more easily than before, so if you are in favor of that, you go this is a BYE. I like what I see in Europe.

Also, we have had some big bailouts of the Italian banks. So everybody goes they are definitely going to write a cheque and sort out that debt problem. The Germans have been more vocal about saying we will do whatever it takes. I have recently spent time with the people who run what they call mittelstand businesses. That means big but medium sized businesses in Germany. I have to say all those CEOs

are like if it comes down to it, we will write the cheque. I say guys, you might end up with the tenth of the value of what you have in your bank account right now. They hem and haw, and say but there really is no price you can put on the value of European Union. We are prepared to pay that. We are the only ones with the cash. We hopefully wouldn't have to pay it all once. We can drag it out by kicking the can down the road. So that's what they do.

The Macron thing is interesting because it is like the second coming. It is like suddenly we have a leader who can fix all that ails, which I don't see happening. I think Macron has less likely an environment than even Sarkozy had when he was in the same role, and he had such promise and never delivered anything. We have yet to see how this is going to play out. I think that populist forces in Europe still exist. I think they are going to intensify precisely because growth is beginning. Now that sounds a bit ironic because most people would say if growth is beginning, then populism should go away. But I think people are going to say wait a minute, I think my life would get better if growth came back, and now it's coming back, and I am still not better off. The more they see the Italian banks get bailed out and they say wait a minute how come they can find billions to bail out an Italian bank but they can't find five euros to deal with the 40% youth unemployment problem in a place like Italy.

I think the populism is still there, and the people who don't like populism have latched onto the idea that Macron absolutely evaporates that problem, when, in fact, it doesn't. We still have an issue. Grant Williams is right. Europe still has a reckoning, but they are able to kick the can a little further down the road because these events I mentioned.

**Erik:** What do you see the outcome of this refugee crisis being? We had Italy the other day threatening to issue EU visas to refugees to force other countries to do their part to absorb more people. We have seen German politics affected by what seems like a growing divide in the German populace in their attitude towards accepting refugees. Is this going to lead to a bigger problem or is it coming under control?

**Pippa:** I think there is a much bigger problem in immigration coming. To be clear, I am actually in favor of the freest possible movement of people, which means human capital and goods, and capital across borders. But there are always limits. And the socially acceptable limits seem to be in flux right now across Western Europe. Here's the problem. We are not just talking about the magnitude of refugees we have already seen. We are talking about what's coming. And so this is where the Italian threat is very important. They basically said, look, nobody is helping us and we get all of them because of our geographical location. So unless you guys give us a hand here, then we are just going to issue them papers and then let them loose. They can go anywhere they want in Western Europe. That is of course a bit scary for the rest of Western Europe, which would prefer to have the problem contained,

but they are not prepared to help Italy in the containment process, just as they weren't particularly prepared to give Greece any extra money to deal with their refugee problem, which happens for the same reason. But this is the beginning.

The bigger issue is that you still have a buildup of immigration happening in Turkey, and the Turks have also been very threatening, saying if you don't give us what we want, and we have got a long list of things, then we might have parts of the border that there's just nobody to police it that afternoon. And suddenly, you get a big wave.

But even more important than that, I now see Northern Africa becoming more destabilized. So Algeria, Libya, and Egypt all becoming a little more wobbly and unstable, and that wave of immigration, I think, could begin to dwarf what we have already seen. In addition to that, there's also the fact that everybody in Africa has registered that it is possible to get to the north. Of course, all of them would like to because they are not stupid. They completely understand that there's a potentially better quality of life and much greater opportunity. It is not just a temporary phenomenon. It is now that people in that part of the world have begun to register I can get to Europe. Look, turn on CNN and you will see, which they can all do these days because they have got the telephone in their pocket. The television is on their phone. This is the key thing. The realization that movement may be worth it. They are saying now in parts of even Sub-Saharan Africa that the greatest luxury good, the thing a person will buy when they have any extra money is passage to Europe.

And so this is why there's a really big question about what is the European Union's immigration policy. Do they really have one? Or do they really believe in this concept of having basically no border whatsoever? I think it is a big debate. A lot of Europeans are like we never signed up for a world where we had no borders at all. Others say once you are inside the border, you are in. And I recently had a German say to me. For example, the Polish citizens that were in the United Kingdom weren't immigrants. They were just European Union citizens. This is the type of debate that's occurring. But at the end of the day there is still no money to deal with them for whatever reason they are arriving, and so it will continue to be a pressure on finances.

**Erik:** You mentioned Turkey in passing. Let's come back to that because I am very interested to get your view on where that situation is headed. It seems like the scale of the rhetoric is increasing. We had the leader of state talking about beheading people the other day. We have had threats not allowing German officials to come in and visit their troops at the air base there. Where is all this headed?

**Pippa:** This is one of the most fascinating and complex issues on the global landscape today. We have a huge new picture in the Middle East that we haven't really seen before. And that is we have the new leader in Saudi, who is aligned now with Israel, even restoring diplomatic relations between the two countries. Those two basically

turned on Qatar, and they did it when President Trump came to visit. President Trump basically said hey guys, what do we need to do to get rid of this terrorism problem? And they said fundamentally Qatar has to stop giving these people money. They have been doing it in lots of ways for a long time, but it is really getting more severe now. That's on the back of an interesting event which happened over the last 6 months, which was a big hunting party, a falcon hunting party, from Qatar, that had several members of the royal family. They were all kidnapped when they crossed the border, and held ransom for quite a long time, 8 or 9 months. Finally, the Qataris said fine, we will just pay you to get the royal family members back, and the price of the ransom was \$1 billion US dollars. I say that with a b for boy so that we are clear.

You can image that for ISIS that budget, that's a budget forever. That's not an annual budget. That's like forever. They are funded. This is when everybody went this has got to stop. Plus, Qatar had been a thorn in the side of the rest of the region for quite a while, kind of the upstart cousins that somehow had managed to come into a lot of cash because of natural gas and creating some things like Al Jazeera, which was generating not just cash, but influence. So against that backdrop, once Saudi, Israel, and the United States and the Gulf Cooperation Council all said we are shutting Qatar down, Turkey said let's see whose side we are on here. I think this is the key thing is Turkey views themselves as the regional powerhouse, not Saudi, not the Gulf, not Qatar. Turkey has been cut off by Western Europe, and so what they are doing is jockeying for a position up against these other players. One they are doing it is by aligning with Russia, so Russia has also been aligning with Qatar. It is all complicated because you would think no, the Russians are against ISIS in Syria. But it's not just about ISIS in Syria, it is about regional footholds and diplomatic influence. By the way, the Chinese are in on this too because they understand the importance of the region, and they are not a bigger buyer of oil from Saudi than the Americans are.

So the Chinese have been quietly sidelining up to all these different players to say what can we do in the background, and by the way Qatar we would like to buy your natural gas. Maybe we can do this offline quietly so that nobody sees the revenue you are going to get from us. So honestly, it is like the Middle East usually is. It is one of the most complex pictures anywhere on the planet.

**Erik:** I want to shift gears now to a topic I didn't used to think of as being geopolitically oriented, which of course is your area of expertise, and that is crypto currencies. In the beginning, Pippa, if you look at what BitCoin was at the very beginning, it was something only interested extreme Libertarians who were very interested in financial privacy. Nobody else was paying attention to it. It was designed really to usurp the ability of government to interfere with and control people's finances. It seems that it is almost going through a complete transformation where now we have the Ethereum guy, I forget his name (Vitalik Buterin), meeting with Putin

talking about some kind of partnership to create a digital crypto currency that will become a national currency for Russia. Meanwhile, PBOC is advertising to hire block chain engineers to help to design the digital yuan or digital RMB. So all of a sudden, it seems like what's going on, and I don't remember the gentleman's name. But there was someone from PBOC, a very senior official, saying it was time for central banks to stop ignoring crypto currencies and recognize that we have got to take the lead and we have got to be in charge of these things and design what we want them to be.

Where is this going? It seems like to me this is a game changer if national governments are going to get behind crypto currencies. Where does this take us?

**Pippa:** Totally. I think it is a massive market and geopolitical issue. I have written a little article about this, which I put up on LinkedIn, where I said you have got to understand if the size of your debt problem is so big that it can't be paid off and in fact even inflation, which is the usual way you would seek to default on your debt slowly over time, you can't get enough inflation generated, then there is one further option. And that is you literally abandon the entire system of money, and accounting. I know that sounds unbelievably radical, but we have seen it happen before. I explained the example of Britain in 1834, when they abandoned the traditional system they had used for 1,000 years at that time, which was called the Tally Stick system. So when we say we tally things up or the word stock market refers to the use of little wooden stocks. They were little pieces of wood on which you record every transaction during your life, every borrowing, every lending deal, every asset acquisition, every tax payment.

The way it worked was it was literally a wooden board. You cracked it half really roughly so the two sides definitely did match and couldn't be faked. Then the borrower and the lender each marked all their transactions. The stock end was always the smaller end, so that's where we get stock market. There was a market in the stocks, these little wooden sticks. Bottom line was why would you abandon a system that has worked perfectly beautifully for 1,000 years. The answer is you had 200 years of war debts that had accumulated. They were unable to get inflation up enough without causing social unrest, and so the government said hey, let's take the tally sticks back, and give people this great new innovation called paper money. You can imagine everyone said I am going to hand over this record, this ledger of my entire net worth, and you are going to give me a piece of paper. Really? This is a joke.

In the end, what the government had to do was confiscate the tally sticks, and they took them to parliament to burn them. They misjudged how much heat the fire would throw off, and that is what caused Parliament to burn to the ground in 1834. It was the destruction of the system of accounting and money. In its place, we adopted what we now use, which is piece of paper we call cash.

Today, we are on the brink of similar step change, and the way you will do it is you move to electronic money in conjunction with blockchain. Blockchain is the new ledger, and e-money is the new currency. The question is whose e-money. So everybody in government circles have been watching the Indian experience because the prime minister stepped up to the platform in early November and basically said we are going to move all of you, a billion people, off paper money and onto electronic money, and we are going to do it in three months. They did it, and they did it successfully.

Now governments everywhere are saying we want to do that because, guess what happens when you move to e-money. First of all, you really eliminate the black market because you can't transact anymore without it being seen. And so, for example, the European Union are talking heavily about moving to electronic money because then all this black market activity that happens in Greece and Italy where there's no tax, we will be able to get all that tax revenue off it. That's one reason.

The second reason is with blockchain you have total transparency over every single step of a transaction, complete providence of every single transaction. The question is who gets to see it. I think this is where governments are suddenly a little schizo because on the one side they think they are going to have the ability to see every transaction that you and I and all the listeners are engaged in, but Ethereum has created this platform where actually they won't necessarily be in government's hands, maybe in private hands. The question is can you trust the private hands who are issuing Ethers as much or more as you trust governments. So governments are being to say let's create our own version, and that's where you get the PBOC saying we've got to control this. Because otherwise, you are going to end up with private sector currencies that possibly are trusted more than government currencies, and that will lead to transactions offline that governments can't see.

There was a report going around the Internet recently about some guy who made \$200 million bucks trading on Ethereum in a month, and the question was who will tax that. The answer is nobody. That freaks governments out to say the least, particularly given their debt situation. So I think this is a huge, huge thing, and all investors have to think very carefully about it. I will say one last thing about it. You have got to get familiar with quantum computing, and there is loads of stuff on the net about it. But the reason it matters is because of the speed at which you can process information. We now have quantum computers. The Chinese apparently have the fastest. There is D-wave out of British Columbia, but basically you can break a block chain password or a Bitcoin password in like less than a minute if you have a quantum computer. The question is who is going to have them, and the answer is mainly governments but big corporations are buying them like crazy. Volkswagen just bought one. We are going to see major corporations buying that computer power. The question then is who has most transparency over the block chain and e-money, and I would argue it is going to be whoever has the most and

fastest processing power, which may be governments at times, it may be private at times, it may be fluid. That's what we have to think about as investors.

**Erik:** I want to ask a follow-up question on this because you are just the perfect person to ask it of, which is I have written quite a bit over the years about the future of the US dollar's role as the world's reserve currency. I think it's fascinating that everybody in finance seems to be just assume it is forever. Of course, reserve currencies throughout history, as you know, have changed about once every hundred years. We are kind of due for one. The US has had reserve currency status since 1944, and I would contend that the only reason it is still has that status after we came off of the gold standard, it has been really I think the petrodollar system that's held it together. That even is starting to change as the oil market has changed, so it is time for there to be a replacement. It just seems so clear to me if you are another government, like China or Russia, and your desire as somebody like Sergei Glazyev in Russia has been so outspoken in advising Vladimir Putin that Russia ought to be vying to take over control of the world's reserve currency, the way to do it is to invent a global digital currency, a crypto currency that is government backed that can replace the dollar and become the global trade currency and eventually also become the central banks' preferred reserve asset domination currency. Am I crazy to think that that's where this could be headed and that the crypto currency boom could actually result in the demise of the US dollar as the world's reserve currency?

**Pippa:** You are not crazy. I think this is definitely the thought process that's in play, but it is very interesting how different governments are proceeding. So I think there is a bit of an arms race on this front between particularly China, and the US. China's choice is to pursue the analog version of the future, and America and the West's choice is to go for the digital.

Let me explain what I mean. The Chinese realized that their economy was coming into a period of not just weakness, but they might have lost their edge entirely in manufacturing. That's because their wages had gone up so much, and basically the costs have gone up so much that they are just not competitive anymore. You probably saw recently that Foxconn, the second largest employer in China, that they are looking to build a production facility in Wisconsin and they have been looking at Pennsylvania. The bottom line when it is more competitive to produce your iPhone in Wisconsin than Shenzhen, something pretty big has happened.

So they decide to pursue an entirely new geopolitical strategy, which they call the Belt and Road Initiative. It is really important for everybody listening to spend time on this because it is the biggest infrastructure build out in modern history. It is all about connecting China to the rest of the world by rail, by road, building highways, airports, ports, physical linkages that are quite literally going across the entire world economy. Their idea is that if they build these roads and linkages, then all the

places along the way are going to buy their products, their excess capacity in steel and concrete, they are going to get familiar with their brands. Guess what? They are going to use Renminbi, and so this is a way of compelling the world to start transacting with China in their currency. Then the PBOC comes in and says actually we would like to create a digital version of the Renminbi, but what they are not saying is they want a global currency because that would require even their own citizens to have access to their Internet. In fact, what they are doing is the opposite. They have introduced what has been called the Great Firewall, which is kind of like a digital Berlin Wall that keeps the citizens inside and stops them from connecting to the outside. For example, the Chinese now cannot legally access the top 3,000 English language websites, including Dropbox and DocuSign. We are not talking about news media. We are talking about the standard building blocks of deals and acquisitions and mergers.

So they are forcing everybody onto Mandarin speaking platforms, which of course is tricky for the West. So it is creating a real split, but it is all about using the Renminbi. If they have to have a digital element of that in order to retain the greatest control and make it as flexible as they can, that's what they want to do.

The West is going a different way, which is private entities are creating their own private digital currencies. Government so far is saying we can't really regulate it, so we had better join them than trying to beat them. And so this is why we see the Western governments saying let's create a digitized version, but their focus is on greater usability on like I said cleaning up the black market. That's why I say it is interesting that I think the Chinese are going the physical, analog route, and the West is going a digital route. But they are all competing for who is going to pay for what in which currency. This is the open question. That is the fundamental question. Like I said, the Chinese are now a bigger buyer of oil from the Saudis than the Americans, so at some point if the Chinese say we don't really want it to denominate in dollars anymore. Let's have it denominate in the PBOC's new digital currency or let's have it denominated in Renminbi. Yeah, it's going to change the cash flows in and out of the US economy for sure

**Erik:** I would think too just as they are used to having an onshore and offshore Yuan market, that if they wanted to, they could engineer a digital RMB, which gives them the ability to control both international transactions that are available to transact these digital RMB with international corporations, versus in-house digital RMB, which Chinese citizens can use to conduct commerce with each other but are not allowed to go over the border. It is just a little flag or bit some place that's turned on that says whether or not it is allowed to work internationally. There's probably no limit to the number of things they could engineer if they wanted to.

I want to ask another question because I am looking at the Belton Road Imitative page on Wikipedia. It talks about all of this great stuff, building infrastructure, blah,



blah. I think wait a minute. Donald Trump campaigned on saying all of the same stuff, building airports and roads and so forth. Of course, that was campaign talk, and it has not so far gone anywhere in terms of any actual big infrastructure spend program, truly passing Congress, being approved, and the cranes are actually building stuff.

What's the status of this in China? Is this just Xi Jinping talking about this stuff? Or is it really happening?

**Pippa:** It is really happening. It is happening in really obscure places as well. I was recently in Oman in the Middle East, and they are building what will be one of the largest ports in the whole region in the spot which is currently a fishing village with 10,000 people. They are really building this thing. It is important for everybody to look at the maps. I actually put them up both on Twitter under Dr. Pippa M, and also on Instagram to help people understand just how big this thing is. So very quickly it is a physical roadway that goes all the way from eastern China through to the United Kingdom through to Spain, but also throughout the Middle East. It is railway links. We have already had the very first train railway line is completed between London and Yebu in China. It is already going once a week. It is not even a maybe. I mean it is live. It goes to Madrid, and back to China.

They have just announced a third element of one bet, one road, and the next bit is called One Circle. One Circle refers to the Arctic Pathway which is a maritime pathway. They are able to get from Dalian in eastern China to Rotterdam in western Europe in 26 days, which is a huge event in terms of shipping but also access to proteins because the Arctic is full of fish. The Russians technically control it, but the icebreakers China has are so much faster they are like I can't hear you. We picked up a lot of fish, but what. I think there's going to be a lot of focus here.

To be clear, the belt refers to the physical roads and highways and railway links. Ironically, the road refers to the maritime Silk Road, which is the maritime pathways that run from China around India into the Middle East but now also around Africa. And it is in Latin America too. They are all over Mexico. They are building out the canal in Nicaragua. They are building one of the biggest ports on the west coast of the Americas. Bigger than Long Beach will be on the west coast of Mexico. So this stuff is not hypothetical anymore. It is a genuine, physical build out, and it is live. It is important because investors need to decide. Is this the thing that bankrupts China? Or is this the thing that affirms China's place in history? That's an open question.

**Erik:** We are going to have a link in our research round up email that our registered users already reserved that will link to the work you have already done. I would love to go further into depth onto it, but we will just refer people to your writings because I want to move on to another topic that you just alluded to, which is post Donald Trump and the wall, which who knows when and whether it is really going to be

built. It seems like a lot of the finance community has written off relations with Texas and Mexico as having any future because President Trump is going to build a wall. That's going to be it. There's going to be no more Texas US commerce. It is going to be all over. You have a very different view. Please explain.

**Pippa:** Yes, I have exactly the opposite view, and it is not that I am a fan of Donald Trump. I don't like the bluster and tone any more than anybody else. However, what's interesting is that because Mexico is so competitive, because their wages are 30% to 40% cheaper than China, because their quality control is America standard because they are so integrated into the US supply chain, actually the wave of immigrants has slowed dramatically. So they are not coming north as much as they were because they got jobs at home.

When I go anywhere in the US, and I say this to CEOs, Chief Investment Officers, they say we are putting way more capital into Mexico, and we are not all perturbed by Donald Trump building the wall because we are going to use a really nifty piece of technology called an airplane and we are going to fly over it. So the wall doesn't really do anything to the degree of integration between the two economies at this point. This is classic politics. You are always building a wall 10 years after you actually needed it. That's always the way it works, so I actually see that the most dynamic part of the industrialized world if I have to name what is the hottest economy in the world today, in the industrialized world, that's the Texas Midwest Corridor. If I have to name what's the hottest emerging market, it's Mexico. They are right next to each other. I see a massive ecosystem that the wall won't even touch, so yeah, investors are going that's a dead end. Meanwhile, it is absolutely on fire.

There are other pieces too, like the new Silicon Valley is Austin. In terms of technology and innovation, Texas is in a leading position in property, agribusiness, energy. It is so diversified, so I see that as the number one place where capital can make a really great return at the moment that everybody thinks it is the worst.

**Erik:** Finally, Pippa, I would like to go to a topic that I know a lot of people are going to be very interested to hear from you about, and that's the President's working group on financial markets, better known as the Plunge Protection Team. If you were to believe in the rhetoric that you see and some of the conspiracy minded blogs and podcasts on the Internet, this is a sinister organization that exists to undermine free market capitalism by imposing government control and manipulating markets much to the dismay of short sellers and gold bugs and so forth. You have the distinction of having actually served in real life on that so called Plunge Protection Team. Tell us what they really do there. What was it like? What experiences and insights did you gain from serving on the PPT?

**Pippa:** What is it really? It is a working group that is the Treasury, the Federal Reserve, the controller of the currency, somebody from the White House. They call it the plus

one. When I was on it, I was the plus one for the White House. Basically, they are there to confer, to swap notes about what's going on, especially when there's a big emergency. They do have a quote trading room, and the trading room is basically a place where they can watch markets, see prices, and see how things are unfolding.

What is isn't it is not a hedge fund. It is not an entity that can just enter the market and buy stocks. It is not like Hong Kong where they can say we are now buying stocks and suddenly the market moves. It works in more subtle ways. My sense is it is a talk shop. It doesn't have anything like the influence the markets attribute to it. The more important thing is that all the big financial institutions, they understand that it is better to get along with Treasury and the Fed than be obstructive or confront them. I would go even further, and I said this is in my book Signals, that a lot of people in government are definitely looking to work in the private sector when they leave. So you don't want to do stuff that's really disruptive to the banking sector if you expect to be named vice chairman of a major bank. So what I think actually happens is when we are in a big emergency, Treasury knows all of the people in the banking system. They are buddies, and they play golf together. They get together and go it looks really bad. It would be good if somebody came into the stock market and bought some stuff. That would be good. Yeah, I think so. Then the order goes out to the trading floor buy stocks Monday morning. It is not because they were required to or because the government in any way has issued an order. It is just a sense of I think government is enough uneasy that they will do something. Nobody asks what can they do. They just assume it is government, so they go I think they might do something so we had better get in front of this.

This is why the power of words in government is so important. What you get in government, quite literally when you go serve in any of these roles, you get a pen and a flag. It is really important to understand the power of the pen and the flag. You literally write or you say words, and the market moves. You need to do actually intervene in the stock market directly or the bond market. All you need to do is put the word out that you are getting a little uncomfortable with prices where they are, and you would rather see them somewhere else. Lo and behold, the market starts moving.

It is not the Plunge Protection Team that actually do this; it is much more subtle. It is much more subtle than that, and it would happen even if you didn't have a Plunge Protection Team. It is just Wall Street sniffing out what's the sensibility of Washington. Having served on it, whenever I read these articles saying we had so much power and we controlled the markets, I burst out laughing because I thought they couldn't punch their way out of a paper bag. But perception is everything in markets, and the perception is not wrong that government can influence the tone. I just don't think it does so directly as people think.

**Erik:** So what you are saying is that the trading room that is operated by the Plunge Protection Team is for monitoring only. There is no account with which to massively short VIX futures in order to try to suppress volatility. There is no money to spend to try to influence prices in the market. Is that correct?

**Pippa:** There is one entity, and it has been so long since I was there I am ditzing on the name. It was created to deal with Mexico when Mexico had the Peso collapse. Bob Rubin was there at the time, and basically they took oil as collateral in exchange for the loans that they made to Mexico. That's it. It is called the Exchange Rate Stability Fund. That is a pool of money that is available to the Treasury, and they can deploy it in markets. It is subject to congressional oversight, but Congress gets mad as hell every time they actually use it. What Congress doesn't like is having pools of money that are not subject to congressional oversight prior to their use. In practice, you have the Exchange Rate Stabilization Fund as a mechanism you could use, but I think in reality it is not actually used very often. But the fact that it exists makes the market guys go, they could.

All you have to do if you were sitting in that seat on the trading floor of the Treasury is ask for a price. You don't have to tell the market what to do. You just have to call up and say just checking prices. You check prices at the right moment, and everybody knows which side of the trade you want the market to be on. Suddenly, they all start moving. Again, I don't think that it's really about the direct deployment of capital most of the time. It is really about using the words to create the impression that causes markets to start doing things they might not otherwise be doing.

**Erik:** Let's pick up on that then because recently Janet Yellen and several other Fed officials have been quite a bit more outspoken than they have been in the past saying we are getting to get concerned about asset valuations and there being too much froth in the stock market. Does that mean people are getting the memo and the big banks are going to reverse? We didn't get into your view on stocks, but I know you have had generally a bullish view that markets probably are headed higher. Do you start to take pause and say wait a minute, Janet is signaling the powers that be that they ought to put the brakes on? Does that change your outlook as far as equity markets are concerned?

**Pippa:** Actually not because this is another thing with the power of words. With government, what you can't do is say one thing and do another and have the markets believe them. Here we have the Fed and every other major central bank in the world has issued a record amount of liquidity into the world economy. They have done it simultaneously over the last decade. So roughly let's call it \$18 trillion US dollars' worth of new money in the system, and it's got to go somewhere. Meanwhile, Yellen says I am not very comfortable with asset prices where they are, but at the same time while I might marginally begin to raise interest rates ever so

fractionally and slowly, but I am not actually going to take back \$18 trillion dollars' worth of liquidity. In an ocean of liquidity that we have just created, we are taking back three drops.

I am sorry, but the stock market is going to go up because you have created the conditions for inflation to accelerate. You have had all this cash sitting on the sidelines worried about the future. Finally, actually the future maybe is looking okay. Growth is okay. The world seems to be recovering. What they are really worried about is all the money they put in the system was fine as long as it sat on the sidelines, but now it is starting to deploy. It is a bit like saying let's throw around all this liquidity because it is like petrol. It is like gasoline. It is an accelerant to make the economy burn faster, but don't worry about inflation because there's no spark. It will never actually start. Then suddenly there's a spark because everybody goes the stock market keeps going up and I can't be left behind. I have missed it the whole way up here. Let's get in. Now it really starts to roar.

People say to me stock markets are all time record highs. You can't possibly buy up here. But that's before \$18 trillion dollars went into the system. Whatever was the old high, it is \$18 trillion dollars less than it is going to be. I don't mean to say that all \$18 trillion is going to end up in the stock market. Some of it will end up in bonds, and some of it will stay on the sidelines. I think whatever amount of money is available, much more will go into the real economy. Partly because if growth and inflation are actually coming back, and I would argue they are. The Fed says no, no, no, they are not. I would say just look at the cost of living that you personally face. Do you feel like your rent is rising? Do you feel like you are paying more for your groceries? Are you noticing that every time you open the darn box of cereal there's less cereal inside but you are charged the same price? All of that is signaling inflation, albeit marginal, is starting to get a foot hold.

In that world, you can't own cash. You are like get me out of cash. You don't really want to be in bonds. So what are your options? Real economy. You can either by equity or private equity, or you can go build a business or you can lend to somebody building a business. These are the main options, and what I hear from the biggest global investors is they are all in on the real economy angle because everything else is so uncomfortable. Frankly, people are innovating. We have incredible innovation going on. I would argue we are in the second industrial revolution. This technological revolution we are in is so huge. People can't afford to not invest in it and be part of this massive disintermediation process.

Profits are there, and money will find their way to them. That's why I say this idea that the stock markets are about to crash is based on an old notion of what the all-time high ought to look like. By the way, can I just add the \$5 trillion that China's one belt, one road initiative adds to this picture as well, on top of all the rest? So that's a lot of money developing the world and connecting it together better. Do you

really think everything is going to pull back? By the way, last thing on this, every institution I deal with, if I tell me if the stock market would just fall anywhere in the world by 10%, we would fall to our knees, thank God in heaven, and buy everything. If it fell 20%, they might drop to their knees a little more slowly, but at the end of the day, sooner or later they have got to do it, especially in light of the fact that we have got everybody's pension fund so massively underfunded. The aging population, we have got to get returns and performance from somewhere. Unless you are telling me this is all going to be worse than the financial crisis and now people are immune to that because they are like I have been through that, and I lived; I survived. Government can't do as much as before if we had such a crisis, but they are not completely out of ammo. Do we really want to test governments and bet that this is time is different? No. If governments want to step in and find a way to issue more money, they will. So it just means more inflation in the future, which has been my core bet. Everything they are doing is telling us more inflation in the future, and that is what you want to get in front of.

I am all over finding genuine, unimpaired cash flows, hopefully enhanced by new technology. You want brands that people will be committed to no matter how rough it gets out there, and so I have to say I'm still long, my argument is stocks are going to way higher than you ever imagined.

**Erik:** We heard a different view last week from Dr. Ben Hunt. Who said the Fed, we are going through a regime change here. It's been 8 years, the tide has been coming in. We are adding liquidity. We are growing central bank balance sheets around the world, and now we are finally talking about shrinking them. Exactly when they start shrinking them and how much they start shrinking them, that really hasn't been decided yet, but the mood has changed from where is the next opportunity to ease to where is the next opportunity to tighten.

If I am understanding you correctly, it sounds like your retort to that argument would be they just added 18 trillion gallons to the swimming pool. Now they are talking about opening a quarter inch drain hole in the corner some place. It doesn't matter.

**Pippa:** Exactly. Well put.

**Erik:** It will someday when we start opening really big drain holes. It will matter. But as far as what's being discussed now about the Fed beginning, it could potentially be a psychological signal. We are shifting from growing balance sheets to shrinking balance sheets, even if shrinking very slightly. It sounds like you are not concerned about that trend change.

**Pippa:** I hear you. I get it. But let's face it at the beginning of a rate hiking cycle, this doesn't cause the economy to flip on a dime and turn into a recession. If it does, that means you have made a terrible mistake. Usually what happens is rate hikes

reinforce the notion that we are actually growing. It is okay. The future is going to be better. The Fed feels confident enough that they can take a little liquidity back and do it super gently, and give you 15 warning notices before they do it. So no big surprises. That's an investible environment. So the question is where's the break even. I think nobody knows anymore. You can use a Taylor rule. I think John Taylor is a genius, and his back of the envelope Taylor rule is one way to look at it. Paul Volcker might use a different configuration and formula. Both of them would agree the breakeven is way higher than it ever used to be. We would have to have a lot of rate hikes just to get to neutral, let alone begin quote tightening. Right now we are not tightening. We are just normalizing from a truly absurd and historical level of liquidity.

Once you get back to something with some semblance of being normal, then we can talk about quote tightening. So this is the thing. The early stage is normalization. Later we actually tighten and constrain the market. But you can't even begin to explain what we are doing now as that phase. The other thing is again looking back at history to understand how inflation works. The early stages of inflation, everybody is happy. Because asset prices are rising and you are not yet registering how much your grocery bill or your rent is going up. Frankly, you are getting wage hikes. I look at the world, and what I see are wage hikes galore. I see the Chinese are getting wage hikes. They have put their wages by 5 times in three years. They look on track to do another 10% per annum. But in the meantime people's wages are rising in some emerging markets, the big ones that matter. In the US, we are getting wage hikes for skilled workers. Every Chief Executive Officer says I have got a shortage of skilled people, and I will pay these people whatever they need. There's a surplus of unskilled people, and they are not able to get whatever they want. That's a big problem. We have basically two economies, one full of people who are fully employable and there aren't enough of them, and one economy that has too many that aren't employable under almost any circumstances.

By the way, Janet Yellen is feeding the second economy, expecting that the first one is on fire, but they are rich, they are educated and they can look after themselves and figure out what they need to do. Again, I come back to the point if we are in the early stages of the inflation that was intended to be created by the injection of quantitative easing, asset price purchases, and low interest rates, then we still have a ways to run. Another thing is markets are so short-term focused. Everybody is like what's the trade for the next 30 minutes, let alone this afternoon. They forget that things like inflation take time. When the Weimar Republic began the process of flooding the market with liquidity, it took 4 years before the inflation really began. When it did, it ripped. I mean it went fast. Today, I don't think we are going to have that same kind of inflation because technology and technological advances and aging demographics arguably although you can make the case the other way, both potentially hold prices down over the long time. But a move from one percent

inflation to two and a half, that is a massive change from the point of view of a pension fund or a big institutional investor. Retail investors should be no less respectful of that massive move. Just because it sounds small, and so as that gains momentum, this is again.

We are going to see my house price is going up, and the stock market is a little higher. I have been waiting for a long time to do something with my cash. I think I have got confidence now to go build something and bang, we are off to the races. Then the Fed is going to have raise rates by more and faster. We will still have a period of time where people go that's good, that means we are growing. I would argue it is not until you actually start to feel the asset erosion, the pain that inflation causes, before people start to go wait, we are on the wrong road here. That's when you start to hit the brake area, but we are a long way off from that.

One last thing and I know I am talking a lot, but when I look at the map of history, what I see is the last great inflation started in 1962. The Fed would say 1965. It gained momentum, and it was caused by trying to have guns and butter. Remember the Kennedy and Johnson administrations wanted the Great Society program, and they wanted to finance the Cold War. We have got more liquidity in the system; inflation began. But it didn't really hurt anybody until the early '70s, and then they tried price controls. Then the OPEC crisis happened. They tried more price controls, and then inflation just got worse. Only in 1974 did they start to say maybe we had better do something about this, and from '74 to '79 they argued. Is it inflation? Is it unemployment? I don't know. I think it is inflation. I think it is unemployment. They had the stop go era where you slammed back and forth between two extreme policy trajectories, and that confused everybody until finally they said it is inflation. They hired Paul Volcker.

This time, how long will it take? With technological change, the speed at which information and money flow in the economy, maybe it is half the time. That's from '65 to '79. Now, how long is that? Half the time, that's about where we are right now. In my view, we are just at the beginning of feeling the positive impact of all that liquidity the governments gave us and we should also be preparing for the next impact that will come, but it is not yet with us.

**Erik:** Finally, Pippa, before we close, for our listeners who want to follow more of your work, tell us what you do at DRPM group and where they can find out more about you.

**Pippa:** I am advising big institutional investors, but I am also writing books. I have a book called Signals, how everyday signs can help us navigate the world's turbulent economy. I put up stuff on Twitter under Dr. Pippa M (@DrPippaM) all the time, and I write on LinkedIn. I am really looking forward to engaging with your listenership.



**Erik:** Fantastic, and we will have a link in our research roundup email so they can find your work on LinkedIn and elsewhere on the Internet. Can't think you enough, Pippa, for another fantastic interview. Thank you for coming back and joining us. Patrick Ceresna and I will be back as Macrovoices continues right here at Macrovoices.com