Dr. Lacy Hunt: U.S. Economy will continue to decline for the balance of 2019

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Erik: Joining me next on the program is Dr. Lacy Hunt, chief economist at Hoisington Investment Management.

Dr. Hunt, before we get started I just want to credit you and make sure our audience is aware, the last time that you were on the program, everybody and his brother was screaming at the top of their lungs, okay, look, that's it. It's clear, the bond bull market is clearly over. We're headed to much higher yields.

The big number that everybody was watching was 3.10% on the 10-year yield. And so many people said, boy, if we get past that there's no turning back, it's the end of the world, the sky is falling, that's it for the bond market.

And just as that was happening, we had you on the program. I believe it was the same week that we first broke 3.10%. And you were very confident and very assured and just saying, look, it's lonely sometimes. But I'm sticking to my story. My fundamental view has not changed. It is very much opposite consensus and this is a buying opportunity for bonds, not a reason to panic.

That was so out of consensus at the time and, needless to say, you have been proven spot-on correct ever since then.

And I also want to just make our listeners aware this is not the first time that you've been out of consensus and correct. You've caught all of the major bull and bear markets in the bond market since the late 1970s. So congratulations for the excellent track record. And thanks so much for joining us again on the program.

Dr. Hunt: Well, it's my pleasure, Erik. Great to be with you and thank you for remembering my record.

Erik: Well, it's my pleasure to have you back. Let's, for some of our newer listeners, let's start by briefly reviewing your outlook for the economy, what you think is going to come next for both the US and the global economy. And then we can get into a little bit more on the fixed income markets.

Dr. Hunt: Well, the overriding concern for us is that the US economy and all of the major other players in the global economy are extremely over-indebted. And this debt is a hindrance to growth. It is also a factor that retards inflation and is the main ingredient that has controlled the environment of low interest rates for an elongated period of time.

It has been our view that trying to solve an indebtedness problem by taking on more debt is not the solution, that it only aggravates. You can take on more debt, as we have done, so many times – and there is a transitory benefit to the economy. But the benefit fades very quickly.

As a result of that, the transitory spurts in economic and inflation, which do occur, are relatively short-lived. And they give way to periods of weaker economic activity, lower inflation, and lower interest rates.

And, as long as the indebtedness problem remains at forefront of the domestic and global economic situation, it's our view that we're going to continue to persist with this lower inflation and interest rate environment for a longer period of time.

Erik: And what is your outlook, say, for the next 6 to 12 months for the US economy? A lot of people are saying we're headed for recession. Would you agree with that view?

Dr. Hunt: Well, the economy is very weak. We're in a downturn.

The economy held up reasonably well in the first quarter, principally because of a very substantial drop in the current account deficit which contributed about 1% to GDP growth in the first quarter. And also a very sizable increase in inventory investment in the first quarter after a large contribution to growth from inventories in the fourth quarter.

So the first quarter's growth rate will start off somewhere around 2.5%, which is more or less about the same as it was in the fourth quarter.

But more forward-looking elements of the economy deteriorated. The rate of growth in consumer spending was only 1.5% annual rate in the first quarter, down from 2.5% in the fourth quarter.

And, in fact, it looks like the six-month rate of growth in real consumer spending for the latest six-month period is approximately the weakest since 2013, which is a very significant statement.

The gain in the trade sector and the buildup in inventories are likely reversed as we move into the second and third quarters. And by the end of the year I think growth will be only barely positive, perhaps even stationary.

So we're peaking in terms of the growth rate in the first quarter. And we're set to move significantly lower in the second, third, and fourth quarters of the year.

A couple of things that we're looking at that suggest this: The Federal Reserve has engineered a very significant monetary deceleration, one that has reduced the rate of growth in bank credit and money supply in the United States to very weak levels. And the Federal Reserve's restrictive policy has reduced the world dollar liquidity, which has in turn caused a major monetary deceleration in Europe, Japan, and China.

The Fed's restraint has also resulted in a synchronized global downturn. In fact, the downturn is more significant in Europe, Japan, than in the United States.

Now, a lot of folks are optimistic because the Chinese pumped in a record amount of new debt in the first three months of this year. And they are assuming that this huge surge in Chinese debt will lift the Chinese economy and the Chinese economy will provide some propulsion to the global economy.

But one of our critical points is that, when one looks at the production function of the US and the global economy, the overuse of a factor of production, such as debt capital, results in diminishing returns at some point. And we think the Chinese economy is at that point.

So, contrary to most folks that are very optimistic about China's growth picking up significantly as we go through the year, we expect that the huge injection in debt will be very short-lived and that the Chinese economy will falter as we move into the latter part of the year. And we think this synchronized global downturn is going to be very, very difficult to shake.

A couple of things that we're looking at on the monetary side: Last year, at the end of the year, the M2 money supply growth was 4.2%, which was in the lower quintile of growth rates on an annual basis since the end of World War II.

And, as of the first week in April, the rate of growth in M2 has decelerated even further down to just 3.9%, which is only about half of the long-term rate of increase in M2 since 1900. It's a very, very weak rate of growth.

In addition, bank credit growth has decelerated as one might expect. The yield curve has flattened very considerably, and this tends to undermine the profitability of those that are borrowing short and lending long. So the monetary policy is constrictive.

The benefits from last year's big increase in the federal budget, which funded a household tax cut, a corporate tax cut, and also a fairly sizable bipartisan increase in spending – we think that those benefits, which were debt-financed, are largely behind us and diminishing returns will also take over there as well.

So we're at the best rate of growth now. And the growth rate is going to get progressively weaker as we move through the rest of the year.

Erik: So we're headed down in terms of growth. And, obviously, for the reasons that you stated at the very beginning of this interview, that should be constructive for bond prices, meaning lower yields.

Do you have a forecast or rate forecast that you work with for what we should expect in terms of both US and foreign yields? Or do you only work in terms of the expected direction?

Dr. Hunt: Well, we're really only good at direction. We try to make a multi-year assessment.

But I did a little exercise that I will share with you. We looked at three significant monetary decelerations that occurred in the post-war period when the Federal Reserve managed to avoid a full-scale recession, but there was a quasi-recession.

The Fed engineered a slowdown in money and credit growth, such as they have today. The yield curve flattened significantly – in some cases actually inverted – but a recession did not ensue.

And those three cases were in 1966 and 1967, 1984 to 1986, and then from 1995 to 1999. Now, in each of those cases the economy got very shaky and there was also a financial failure as a result of the monetary restraint.

In the 1960s it was the failure of Western Equities. In 1984 it was the failure of the Penn Square National Bank and the Great Continental Illinois National Bank. And then in the late '90s it was the failure of Long-Term Capital Management.

But in each of those cases, the Federal Reserve moved rather quickly and, on average, they cut the federal funds rate by 300 basis points. Even with that, the inflation rate fell by about 130 basis points.

Now here is the difficulty: In those earlier cases, where the Fed faced a weakening economic situation, the demographics were better than they are today. Population growth is at an 80-year low. The economy was not nearly as overleveraged as it is today. And the global economy was considerably stronger.

So those earlier cases presented the Fed with a better opportunity to get out of the mess. But today, the Fed is not in a position to lower the federal funds rate by 300 basis points. We would be constrained by the lower-bound.

And a drop of 130 basis points in the inflation rate would take the inflation rate down to five to six tenths of 1%, which would mean that there would be some important sectors of the economy that would be in actual deflation.

And so the risk is that, in the process of trying to contain the slowdown as it moves along this year, we will go back to the zero-bound for the policy rates. And they will be stuck there for a multi-year period, much as we've seen in Japan and Europe. And that is the main risk in the interest rate environment as we see it.

Erik: Now, obviously, they can only go as far as the zero-bound until they have to consider other mechanisms of unconventional monetary policy.

Do you expect, once we get to the zero-bound, that there is a pause there and they don't go back to quantitative easing? Or do you think that as soon as we get to the zero-bound, if the conditions warrant further easing, they go right to more QE?

Dr. Hunt: I think that they will take some type of extraordinary measures. I think quantitative easing proved basically ineffective. But, because it's an option, a lever they can pull, it's quite possible that they would do so.

But here is the risk: The unconventional methods suggest that we will then be stuck at the zero-bound for a prolonged period of time, just as we've seen in Europe and Japan.

Erik: And what is your expectation as to how the economy – I guess you could make the argument, okay, once you're at the zero-bound, that's the famous situation where it's all over.

But, of course, as Japan has demonstrated for 30 years now, you can get stuck in this liquidity trap at a zero-bound and, where so many people back in the early '90s predicted that Japan was going to completely blow up and Japanese government bond yields would go through the roof as the price collapsed to zero – none of that happened, and they've just sort of stayed in this stagnant economic condition that has persisted for decades.

So if we get to returning the US Fed funds rate to zero, and they're considering and maybe using some other extreme methods, how long could that go on before we get to a complete reset kind of situation where the whole system has to come into question?

Dr. Hunt: Well, a lot of folks have made that argument, that the indebtedness problem is pointing to some sort of blowup. That argument has been made in the case of Japan. That argument has been made in the case of the US.

This has caused others to say, well, look, the Cassandras of the debt problem have been wrong, because we haven't had a debt blowup. And, in fact, people continue to clamor for high-quality, fixed-income government securities in Japan, Europe, and the United States at extremely low or virtually unprecedented levels except for recent years.

But I think that analysis misses what history has taught us about extreme over-indebtedness periods. The use of debt triggers diminishing returns, which is derived from the production function.

The production function is determined by technology and how it interfaces with the three factors of production: land, labor, and capital. If you overuse one of the factors of production, initially output will rise. But if you continue to overuse that factor of production, then output or GDP will fall.

What we're basically saying is that the marginal revenue product of debt is falling substantially as more and more debt is piled on to the system.

So the effect of the debt is more insidious. It's more hidden from view than a crisis. But the crisis is there. And the crisis is what's happening to the growth rate and to the standard of living.

If you calculate the rate of growth in real GDP per capita, which is the determinate of the standard of living, from the beginning of the republic in 1790 to 1999, the growth rate was 1.9% per annum.

Now, 1999 is a very critical level because that's when a number of almost two dozen different academic studies indicate that debt levels became deleterious in terms of their impact on growth. And it's also the time period in which the GDP generated by debt began to fall precipitously in Europe, Japan, and the United States simultaneously.

Since 1999, the per capital GDP growth rate has been 1.2% per annum. In other words, we've lost about 45% of our annual growth rate.

Now, I did a little exercise to illustrate this impact. If the GDP growth per capita had been 1.9% in the last 20 year, instead of 1.2%, the per capital GDP right now would be approximately $8,000 higher. It would be $64,500 versus $56,700.

In other words, the per capita GDP would be 14.6% higher. Economic growth would have been better. It would have lifted the standard of living. It would have given greater enjoyment to people. It would have produced more jobs, more corporate profits.

So where the debt is deceptive is that it is undermining the growth rate. To sort of paraphrase T.S. Eliot, the world ends with a whimper, not a bang. It's a longer, slower grind downward. That's the problem with the debt.

And that's what we've seen in Japan. In 1989, government debt was 60% of GDP. In 1998 it was 80% of GDP. And today it's in excess of 210%. And the Japanese have had four recessions in the last 10 years.

The growth rate has been so poor that the population growth in Japan, which was very healthy – it was stronger than in the United States in the mid-1970s – the population growth was 1.6%-1.7% per annum. Last year their population declined .4% per annum, which was a record decline.

So you get into this period of overusing debt, the growth rate comes down. There is no crisis in terms of the financial markets erupting, but the growth grinds down. And, eventually, that undermines the demographics.

And that's a problem now for the entire world. This feeds into the production function in an adverse way as well.

According to the demographic experts at the UN, the world population growth last year was 1.2% per annum, which is an 80-year low. And in 80 years, in other words 2100, according to the UN demographers, the world population growth is going to be down to .2% per annum.

So the world right now is at 1.2%, an 80-year low.

The US population growth last year was .6%. Half of the world.

The European population growth was .3% – half of the US, a quarter of the world.

The Chinese population growth was – let's call it zero. It actually declined slightly, for the first time since the 1960s.

And then Japan is negative .4%.

And, moreover, not only is the population growth deteriorating. Europe, Japan, the United States are getting older.

The average population in China is 40, versus 38 in the US – because of the one child per family and they have a mismatch between young men and young women. The average Chinese age is increasing 6 months every 12 months.

And this similar pattern, not quite as rapid, in Europe.

So, not only are populations growing more slowly, but we have more older people who have less demands for things. Babies and young families are conducive to growth.

If you think of the production function, in the United States every dollar of public and private debt is generating about 40 cents of GDP growth. In China it's 36 cents. In Europe it's 38 cents. And in Japan it's 27 cents.

Using the production function as a gauge of where we're going, the US is going to continue to outperform Europe and Japan, possibly even China. Which means that the rest of the world is going to be hanging on us, draining us.

So there is no crisis from the federal debt, but there are very serious long-run developments that are undermining economic growth, the standard of living, and also population.

One other factor that needs to be discussed: The debt-induced weakness in growth is causing an increase in the income and wealth divides. When you get weaker growth, you leave a lot of folks behind.

So there is no crisis in the sense of a blowup, but there are clear, tangible evidences that the over-indebtedness is harming the economic prospects. And the harm is greater outside the United States than inside the United States. But that creates a problem for us.

Erik: Okay, if I can just briefly summarize all of this to make sure that I have your view correct, you're basically saying that here we go again. We've tried to solve a problem of too much debt with more debt. And, just as you can solve a heroin junkie's withdrawal addiction by giving him more heroin, that works in the very short term but eventually it just makes the problem worse.

We're coming, now, into, by the end of this year, that next slowdown where the Fed will very quickly be forced to go back to the zero-bound with the Fed funds rate. We'll probably have to explore alternative, unconventional means of easing.

And this puts us back in a situation where, as you say, we're not facing the conspiracy blogger scenario of the whole world blows up, but rather what we are facing is maybe the entire developed world kind of looks like Japan has looked for the last 20 or 30 years, which is extremely weak economic conditions because the country has been burdened with just too much debt.

And it sounds like you're saying that the whole developed world takes on those symptoms and conditions. But, just as Japan has not blown up completely, the rest of the world doesn't blow up. We just get stuck in a situation where the entire economy is slave to excessive debt.

Is that a fair summary of your views?

Dr. Hunt: I think it is a fair summary. And I think it is correct with historical analysis. The great David Hume, who is known as the father of the enlightenment, a tremendous thinker – Adam Smith, who was mentored by Hume said he was the greatest intellect of all – wrote a paper in 1752 called "Of Public [Credit]" which is on the internet. You can read it and it's well worth reading.

And Hume looked at all of these cases of extremely over-indebted economies up until the point that he wrote the paper. He looked at the Mesopotamian and Roman Empires and a number of much smaller cases that have entirely been forgotten.

This is what he said toward the end of the paper: *When a state has mortgaged all of its future revenues, the state lapses into tranquility, languor, and impotence*.

So that's the pattern. That's the long slow grind downward. This has led me to develop an interest rate theorem that i think is very useful. And it surprises a lot of folks.

My interest rate theorem is that government debt accelerations lead to lower, not higher long-term government yields. And when the debt levels are already high, and there is an acceleration in debt-financed activity, there's a transitory gain in economic activity but it doesn't last very long. And then the economy weakens.

And when the economy weakens, then the inflation rate moves lower. And when the marginal revenue product of debt declines as it does today, it pulls the velocity of money down, which results in additional downward pressure on GDP growth. So the pattern is toward lower rates.

If you do a little simple exercise and graph the long government yields in Europe versus the government debt to GDP ratio – just put them on a graph, one on the left axis, one on the right – government debt to GDP, the government bond yield on the other. Do the same thing for Europe, do the same thing for China, and do the same thing for the US.

And what do you see? In all cases, the government debt to GDP ratio is rising substantially and the bond yield is declining. There is a negative correlation, not a positive correlation.

Japan is more pronounced, because they have been in this debt cycle longer than all the rest. We're just in various stages of lag behind them. And that's the course.

So there is a transitory gain. For example, the big surge in deficit spending last year, it produced an acceleration in GDP growth in the second quarter, a little bit in the third quarter. But, by the end of the year, it was really hard to identify.

And I think that that's the case. The benefit from debt-financed activity is very fleeting. There is a benefit, but it does not last very long.

That's what we've seen in Japan in numerous cases and what we've seen in Europe in many cases. And I think we're going to start seeing now in China, when the big surge in debt that they've engineered this year really doesn't produce the results that it has in the past. Because we're further along the diminishing returns curve.

Erik: Let's focus on that diminishing returns curve, because you said earlier that you expect the Fed, because of economic conditions, to have to take us back to the zero-bound. You said, because of this diminishing returns curve, it's likely that they will have to do some kind of unconventional policy action.

But you said quantitative easing really hasn't been that effective. And, of course, it is diminishing in its efficacy the bigger the balance sheet gets.

So what do you think comes next, if it's not quantitative easing? Is it outright debt monetization? Or is it something else?

Dr. Hunt: Well, there are some folks out there, mainly the modern monetary theorists, that want to make the liabilities of the Federal Reserve legal tender. In other words, allow the Fed's balance sheet to sort of operate as a cash cow and to pay for the Treasuries bills.

The Federal Reserve does not have that authority at present. The [Federal Reserve] 1937 Act, the principal author was Senator Carter Glass of Virginia, who also wrote the Glass-Steagall Act, did not intend to give them that authority. He consulted with Irving Fisher of Yale and other great monetary thinkers of the time, and they did not give the Fed that authority.

The Fed can only use its balance sheet to buy a select group of assets from the banks, government, and agency securities – and then those proceeds have to be held at the Federal Reserve bank. So the money supply is equal to the monetary base and the money multiplier, which is endogenous and which the Fed does not control.

And, regardless of what you have heard – and there was once a statement, which was eventually corrected, from Ben Bernanke that in quantitative easing the Fed was printing money – but the Fed does not have that capacity. It doesn't have the mechanism or the tools to print money. For them to be able to print money you would have to rewrite the Federal Reserve Act.

Now you could go down that route. But what would happen in that case is in very, very short order we would get hyperinflation. Because the aggregate demand curve would shift upwards, the money multiplier would no longer be relevant, and prices would rise as fast as the increase in the money supply and eventually faster.

And something called Gresham's Law would take effect. The bad money would chase out the good money. People would not be willing to exchange money for commodities, return to barter. There would be massive inefficiencies.

In the old days, when countries made the central banks' liabilities legal tender, we of course had many smaller producers. Maybe somebody produced eggs and someone else produced milk and someone else baked bread, and you could then barter.

But, today, we all have specialized skills. It would be hard to barter specialized skills. And, of course, we have the mass merchandiser that couldn't operate with a barter system.

Also in the past, when the Federal Reserve's liabilities were made legal tender, those currencies were not the reserve currency of the world. So if we were to do that, it would quickly destabilize the global monetary system.

That's the siren song, and some people are advocating it. But if we were to make the Fed's liabilities legal tender, in very short order nearly 100% of our people would be miserable, absolutely miserable.

Erik: I want to come back to modern monetary theory and some of the directions it could take us in just a minute. But, before we go there, let's come back to the current system.

The way the laws are written now, the system that we live in, you've described this scenario of worsening economic conditions, the Fed eventually returning to the zero-bound, and so forth. Based on that, I know that your process at Hoisington Asset Management is you basically decide where on the curve to allocate long fixed-income investments.

So how do you translate in the current environment? Is it all about duration risk, that you're long-duration here and going all the way out on the curve? Or is it something different?

Dr. Hunt: We do have a 20-plus-year duration. We've had that for some time. And it's been a bumpy ride. We've had a lot of volatility in the long yields.

But let me just give you a perspective. When the Fed first raised the policy rates in December of 2015, the 30-year yield was roughly 3-1/8, and it's been below 3-1/8 since then. We had nine increases in policy rates. We had the euphoria of a generally rising stock market.

But, as things stand as of the end of March, the best-performing part of the Treasury curve was the 30-year. You had a higher coupon and you outperformed everything on the shorter portion of the curve.

In other words, the Treasury market was influenced by a whole host of these transient factors which were very powerful over the short run but didn't really matter. But what did matter is that the overall economic growth rate has been subpar and the inflation rate has generally been depressed and extremely low.

Not that there weren't individual bouts of inflation. You can get transitory bouts of growth and inflation but they're not going to hold in this environment. So it's been our assessment that the best returning asset on the curve would be the long Treasury. And that's where we've positioned our clients and ourselves, because we invest with our clients.

Erik: Okay, so the view in the world as we know it, the current system, is we're in a disinflationary to possibly even deflationary risk scenario, we're in worsening economic conditions. The place to be is all the way out the curve, long-duration risk. And that makes perfect sense.

Now I want to come back to your earlier comments about MMT. And let's take it even a step further. One of the things that Neil Howe's work on generational cycles teaches us is that in periods of history like this, we tend to go not only to extreme leaders, but often society will pivot from one extreme to the other.

So let's assume that your scenario plays out. The economy worsens through the rest of 2019. We go into the election year of 2020 in either recession conditions or rapidly approaching recession conditions. It's not looking very good for the incumbent party.

Suddenly we end up with President Bernie Sanders, Vice President Alexandria Ocasio-Cortez, and they appoint Professor Stephanie Kelton as the new Federal Reserve Chairman. Stephanie Kelton, of course, is one of the major proponents of modern monetary theory – the view that it's perfectly okay for the government to create as much money as necessary as long as there is not an immediate inflation risk.

Obviously, that's an extreme hypothetical. I don't know that we would ever get there. But for sake of argument, let's assume that there is a pivot in social mood to where suddenly more government spending – things like universal basic income, using modern monetary theory to pay for more social spending, forgiveness of student debt, maybe even government subsidized free university tuition – those kinds of things that the political left has begun to focus on sort of come true in terms of those people coming into power.

What does that do to your outlook for fixed incomes? Because, obviously, those would be very inflationary conditions.

Dr. Hunt: Well, if you make the Fed's liabilities legal tender, then all bets are off. And the inflation rate would begin to rise rapidly and that would require a different investment strategy. There is no question about that.

But if there is an attempt made to rewrite the Federal Reserve Act, you're going to have a little bit of time because it would have to go to the House and the Senate. They would have to pass compatible bills and go to the President.

Under the right political circumstances, they could do that. But, even in the best of circumstances, the process would take a little time. And so that would give investment managers an opportunity to reposition their portfolios.

I might also add that the leadership of the Federal Reserve would have to be changed. That could be done as well. But all these things would take time. It couldn't be done overnight, because the Fed does not have the current capacity.

Now you might do something like this: You might say, well, we'll have an announcement from the Fed that they will increase the balance sheet – if the deficit is going to be $2 trillion or $3 trillion, they'll increase the Fed's balance to $3 trillion.

But we already really tried that in 2012 and 2013. The increase in the Fed's balance sheet in those two years equaled the budget deficit. But, you see, in that particular case, existing under the Federal Reserve Act, the money supply is still equal to the base times little m, the money multiplier.

So you would have the Fed buy the government's securities. But the banks would not be able to employ it unless they had the capital to utilize the excess reserves, which was the same problem that constrained the banks from turning the balance sheet into an acceleration in money supply growth.

So when we had quantitative easing, the Fed's balance sheet quadrupled but the money multiplier dropped from 9 to 3. And the rate of growth in money supply did not accelerate.

The only thing that would really be different would be if there was a concerted effort to make the Fed's liabilities legal tender. And my read is that that requires a rewrite of the Federal Reserve Act and also some other companion legislation as well.

It could be done under the right political circumstances. But ,as for the time being, it cannot be done.

Erik: And do you see that as – let's say in the next two to three years, as we go into the next presidential race, if there was a substantial change in national leadership in a new presidential election, do you think that that scenario, where the Federal Reserve Act gets rewritten as you describe, is that a 1% possibility or is that a 70% possibility?

Dr. Hunt: I think it's very low because, keep in mind that even advocates of greater budget deficits, such as Paul Krugman and Larry Summers, have said that modern monetary theory is not workable. There is on outstanding article by Ken Rogoff at Harvard about the unworkability and what it would mean for higher inflation.

So I don't see mainstream academic economists supporting it. And I certainly don't see the Federal Reserve community – Chairman Powell has come out against it. It would take a cataclysmic political shift to want to rewrite the Federal Reserve Act to do that.

Erik: Okay, so we'll categorize that as an extreme outlier, but still a plausible risk, considering that we're in a very interesting economic environment. It's sobering news, to say the least.

Dr. Hunt: It would make everybody's life miserable, including fixed-income managers and everyone else in the economy, because you would barter. And barter is extremely inefficient.

The aggregate supply curve would turn vertical. So every time that they expanded the Fed's balance sheet to pay for bills, it would all go into price. There would be no gain in real GDP. It would just result in rapidly escalating inflation.

And eventually what would happen is that the aggregate supply curve would start shifting inward as more and more people learned to try to operate in a barter framework. I don't know how we could even achieve a barter framework in this specialized world that exists today.

Erik: Well, and of course that would probably create an opening for alternative currencies, whether they be cryptocurrencies or otherwise, to begin competing with government-issued currency on the argument that they are more stable and less subject to inflation.

Dr. Hunt: Well, the main thing to understand is that Gresham's Law would take care of that. In other words, the bad money, the Federal Reserve's liabilities would chase out good money.

Take, for example, some of the cases where central bank liabilities were made legal tender. This was done by the Chiang Kai-shek government in 1935. And it was done by the Weimar Republic in the 1920s.

It was done by Yugoslavia at the end of World War II, Hungary at the end of World War II, and numerous places in Latin America in the last 30 to 40 years. It happened in Venezuela contemporarily.

In the late days of the Roman Empire, there was no central bank. But what was done was the pure metallic coins were replaced by worthless coins. And people wouldn't use them, wouldn't accept them. So they resorted to barter, which even then was complicated.

The Bourbons of France, they had become extremely over-indebted to finance what was known as the Seven Years War in Europe, the French and Indian War in the US, the American Revolution, and they continued living beyond their means.

The government of Louis XVI was unpopular. They couldn't pay off these debts, but they continued their high-living style. So they began issuing worthless metallic coins – same effect. And so people that could moved their assets into assets that held value, moved some into foreign countries, or what have you.

But that would be very, very difficult in the current environment because the US dollar is the reserve currency. So, going along that route would be unimaginably disruptive in my opinion.

Deflation is an uncomfortable environment. But for those that are employed, real incomes generally tend to continue to rise at least somewhat. In hyperinflation, no one's income will rise and everyone would become miserable.

Erik: Well, Dr. Hunt, I wish that we could go on for hours. It's fascinating just to hear your musings on all of these interesting scenarios. Unfortunately, we're running out of time. So before I let you go, give us a quick overview of what you do at Hoisington Asset Management.

Dr. Hunt: Well, I'm the chief economist of the company. We manage in excess of $4 billion of institutional fixed-income money. We've been in business since 1980.

We really don't have individual clients, but we are the sub-advisor to the Wasatch-Hoisington U.S. Treasury Fund. And you're able to get the same type of management in that fund – the symbol is WHOSX – as for our big institutional clients.

Erik: Well, Dr. Hunt, I can't thank you enough for a fantastic interview. I would love to hear you continue to muse on these subjects for hours. But we are, unfortunately, out of time.

Patrick Ceresna and I will be back as MacroVoices continues, right here at macrovoices.com.