



**MACRO Voices**  
with hedge fund manager Erik Townsend

## Summer Special Part 1: Danielle DiMartino-Booth and Peter Bookvar on the Future of Monetary Policy

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**Patrick:** I want to start this conversation with the FOMC statement and the rate cut that occurred.

Danielle, you were on our show on the All-Stars episode before the FOMC meeting. You talked about this as a historic rate cut and that, potentially, it was the onset of a potential new currency war – which you completely nailed. It was a great call that you made.

But, now that this is rearview mirror, what is your impression of the reactions after the FOMC? And what are we looking at here going into the September meetings?

**Danielle:** I think we have to keep in mind what all currency wars entail and the fact that there are not just two players here. This is not isolated to China and the United States.

No matter what happens between the two countries – whether it's South Korea you're talking about (whose stock market has suffered tremendously this year), or the events that have been underway in Hong Kong for some time, or China's or the United States' other trading partners (whether it's the Japanese or the Germans) – none of these volleys in this war occur in isolation.

And, as much as even the most dovish members of the Federal Open Market Committee would like to present otherwise to convey that unified front, there is nothing that the Fed can do or say to contain a trade war if the real economic damage, the collateral damage, becomes to where it seeps onto our shores in the form of increased recession probability – which is exactly what the yield curve has been communicating since that first rate cut that they've said and hoped would be (quote unquote) won and done.

**Patrick:** So, Peter, how does your opinion differ from that? Or do you have a different view of what happened at the FOMC?

**Peter:** Yeah, I feel the same way.

In gauging the effectiveness of what the Fed is trying to do, we have to understand the basic function of what the Fed or other central banks do. When they cut rates, they are encouraging you to borrow money. They are encouraging it for your household or for your business.

When you stimulate from a monetary or fiscal standpoint, you try to convince people to do something today that they may have waited till tomorrow, because they were saving money. And you convince them to try to borrow.

But, with borrowing costs so low right now across the world, as we know – particularly in the US where the Fed is trying to stimulate – there is nothing really left to stimulate.

That's where you get into this Japanese malaise where low rates forever stops being a stimulant because you're not convincing people to do things today. They're just waiting until tomorrow.

And the same thing is happening in Europe. And the same thing is going to happen here.

So what tools the Fed has really are irrelevant at this point.

To Danielle's point, when you get this sort of slowdown that's global right now, and industrial/manufacturing centers (at least for now because of the tariffs that are now spilling over into other areas), this is going to play south.

And what's going to differentiate this downturn, and whenever the recovery after the downturn takes place, is relying on central banks to create some sort of V-bottom recovery is just not going to happen this time.

There's going to be a lot of balancing along bottoms.

There's going to be a lot of churning in the economy for more time than people are accustomed to.

If you look the behavior in the stock market, the stock market still believes in this V-type recovery. And that the Fed can create magic. And Powell can change his mind in January and everything is going to be fine.

And we can complete multiples [INAUDIBLE]. And everything is going to be fine.

And I think we're going to realize that pushing on a string (which has been around forever) is going to be a term that's going to be used a lot more over the next one to two years.

**Patrick:** Danielle, I wanted to circle back to your call that this was potentially the start of a new currency war. And, clearly, you nailed it. Because no sooner did the rate cut occur did we have the dollar strengthen and Trump get out there and immediately escalate tensions with China.

So why were you on top of this? What did you see coming?

And is this playing out according to the way that you envisioned it when you were on the

All-Stars episode?

**Danielle:** Well, I don't think that anybody that anybody in America, or basically on Planet Earth, can envision what our president is going to do next. If they tell you that they can, they're lying.

But I did know that the 25-basis-point rate cut would not be to the satisfaction of the White House. That much anybody could have said in advance.

So his reaction, Trump's saying that he was going to impose the 10% tariffs as of the beginning of September across a much broader spectrum of Chinese goods, was certainly something that could have been anticipated in order for him to get the reaction that he wanted. Which was a full pricing-in of the 25% basis points he didn't get at the July FOMC meeting.

Now, that occurred. And, in that sense, Trump was perfectly successful.

Where the backfire comes in, as we watched retail stocks melt down in the following days – because there are so many companies in the country that simply can't withstand another body blow to their margins when they're already operating at such razor-thin levels – what nobody anticipated, myself included, was that, after over a decade, the Chinese authorities would allow the yuan to trade through the 7 level as retaliation against what Trump had done.

The reason I'm bring this up is because Trump tends to throw things out there and then pull them back once he gets the result that he wanted.

Well, if the result that he wanted was simply the market fully pricing in a September 18 rate cut by the FOMC, then he might have taken back the tariffs knowing that it might not be such a good idea to try and forcefully put JC Penney, Macey's, and GAP out of business before the holiday season hits. (I'm just throwing names out there.)

But, because of what the Chinese did, because of their response, and because of the Treasury Department's naming China a currency manipulator in further retaliation, this means that nothing can be taken back.

So Trump thinks he might have taken a baby move to push market pricing to where he wanted it to be to get the easing out of the Fed that he felt Jay Powell did not deliver on.

And look what happened.

That is the nature of a currency war. And why it's different than simply President Trump tweeting something out saying, *I'm not satisfied with the amount of love that I'm getting out of the Eccles Building.*

**Patrick:** So, Peter, what's your impression of where Danielle was going with that?

**Peter:** She's spot-on in that it's gone to another level.

We can even take a step back and say, you know what, this currency war actually started back in 2012 into 2013 when Obamanomics came into being, where the yen was around 75 to the dollar.

And one of the purposes of Kuroda doing what he did was to weaken the currency to try to import an inflation. So their currency weakened from 70-ish to 120.

And then you go over to Europe. And Draghi's intent, when the euro was at 140, was to get it as low as possible and import inflation to get to their levels of 2%.

Well we've seen a decline in the euro, of course, from 140 to 110-ish. And we've seen the weakness in the yen.

And their central bank has been able to generate the inflation that they want.

I think that's a good thing that they were unsuccessful, because the last thing those two regions needed was higher inflation.

But the point is that they dramatically weakened their currencies. And Trump sees what they've done. And he's feeling, well, I'm here defending Middle America and the manufacturing base of this country. And we have all these central banks pissing on their currencies and they get the benefit and we don't.

Even though Japan and Germany, these are export-reliant economies that really gain no benefit from the weakness in their currencies.

So it really became the thing to do is depreciate your currency. And the Fed kept interest rates at zero over seven years. So the war has really been going on for years.

But, to Danielle's point, now it's just taken a whole new level. China has now gotten so in the middle of it as the second biggest economy.

**Patrick:** Erik, what is your take on the currency war and this idea of what happened with the FOMC and the rate cut we just had?

**Erik:** Well, I really want to credit Danielle, first of all, for calling it a currency war and describing this FOMC meeting before it happened as the first shot in a new currency war. Because that's really what I think it is.

And, frankly, where I think the world has been stuck for the last several years is we know a currency war is coming, but we're not quite ready to get into competitive devaluation yet

because everybody knows that it's not really good for anybody in the end.

It's sort of like nuclear mutually assured destruction: We're all smart enough not to get into it but, once you do get into it, everybody piles in at once.

And I think we've been waiting for years for that moment where we really go into, okay, this rhetoric war turns into a shooting war. Except the shooting is not real shooting, it's shooting in monetary policy through competitive devaluation.

And I think that's now begun. And I think Danielle called it on MacroVoices before it happened. So I really credit her for that.

The thing that I'm perplexed by out of this whole thing is this language about the mid-cycle adjustment. (And I think Danielle may have said this on the show too.)

So, if this policy process started in 2009 and it's 2019, that's 10 years in. So if that's mid-cycle at 10 years, does that mean this is a 20-year cycle?

What the heck is going on?

And I don't know about you guys. But I never saw that one coming that Powell would say, *I just want to be clear, we're not starting a rate cutting program here. This is not a rate-cutting cycle. We're just playing around here in the middle of a different cycle.*

That seems to me like an incredibly self-defeating act.

And I would have thought that, based on the market reaction to it, that he would have done the usually politician thing and said, *Oh, you guys misunderstood me. That's not really what I meant to say. I'm going to now say something completely opposite and you just misunderstood.*

No, he really went out of his way to stick to his guns and say, *This is really what I meant.*

Do you guys have any insight? And what is driving him?

Danielle, you've worked in the Fed. Why would he do that?

**Danielle:** Well, I think that there are several things going on here because Powell has continued to not get his way.

I'm not trying to characterize him as a petulant child.

But this is definitely the man who wanted quantitative tightening to go on in the background on autopilot. This is the man who wanted to get the Fed funds rate to 3%. And this is the man who wanted to rally his troops and come together and make sure that everybody, all the way to

Bullard, his most dovish committee member, was unified that this would be a won and done.

So I think him coming up with a clever little characterization of it being a mid-cycle rate cut was a way of conveying and cementing, driving through his point that this was going to be it.

Of course, the minute the market heard those words it proceeded to completely throw up. And the reaction was violent.

But I'll take a step back, because a few press conferences ago, Powell was asked about whether or not he had killed the business cycle – which he was implying that he had if we're going to have a 20-year business cycle, which is ridiculous.

But a few press conferences ago when he was asked about it, Powell actually looked happy for the first time in a long time. He got a little glitter in his eye. And he was speaking lovingly of the Australian episode of a near 30-year expansion.

Well, guess what? That was reliant upon a very quiet currency war. To your point, Erik, that's been going on forever because, back in the '90s, obviously, China was manipulating its currency. It is not today.

But Australia was a huge beneficiary for decades, plural. And yet we've now seen – and Peter can jump in here because he's been a fan of Australia's discipline forever now – but we've now seen Australia's 10-year sovereign yields (sadly) trade through the 1% floor to the downside.

I'm sure Peter was watching the same thing as it happened, recently.

**Peter:** Yeah, the Reserve Bank of Australia never really believed in negative real interest rates. And you had much tighter or smaller standard deviations, you can say, of monetary policy over many years, therefore reducing the odds of having booms and busts.

Now, ironically, they've had a boom in their real estate market that is leaking air. But that's a separate conversation.

But, to the point of negative interest rates – or negative real interest rates, let's start there – creates a whole different dynamic compared to positive real interest rates.

**Patrick:** So, Erik, do you have anything to add to that?

**Erik:** What came to mind as both Danielle and Peter were speaking was Dr. Pippa Malmgren's comments, and this was relative to President Trump and the China negotiations. But I think the same principle probably carries over to monetary policy and what the Fed is doing.

What she described is kind of an attitude of US complacency where, I think, President Trump is

of the mindset that he's "Mr. Art of the Deal."

He's going to squeeze the Chinese government as hard as he can to get the very best, to get them to the point where they're really just hurting for a deal. And finally, when it's convenient and fits into his election schedule, he's going to say, okay, I'm ready now. I'm willing to go ahead and cut a deal with you guys.

And what Pippa said, and what I strongly agree with, is hey, don't assume that the rest of the world shares this US view that the US is in charge of everything. China might just say, um, no thanks. We're not playing your game anymore. You've been incredibly difficult to deal with. You had your chance. We're not going to deal with you.

Now, I think China does want the deal. But I don't think they're going to kowtow to the US as much as the US is assuming.

And I think the same thing carries over to central banking.

So many people in US markets, US financial commentators, seem to be talking about how the Fed is going to do this and that and the other thing – as if the Fed were in a position to dictate to other central banks: *Okay, guys, here's the game plan. We're in charge. Here's what we want you to do. BOJ and ECB, here's what we want you to do. We're the Fed, we're in charge.*

I don't think it works that way. I think the ECB and the BOJ are going to do their own thing and I think they're going to see this as a competition. And I think it could get really, really interesting. I think we're in very historic times.

I'm very curious to get Danielle and Peter's reactions as to whether they agree.

**Danielle:** Well, look, dictating is a difficult thing to do even if you are the Federal Reserve of America.

And don't get me wrong. I believe that central bankers are in the habit of and regularly coordinate policy.

I don't think Powell was in the least surprised when, at its July meeting, the European Central Bank indicated that it would be easing policy on September 12 when the ECB next meets. And I don't think that the Bank of Japan's comments have in any way shape or form not been coordinated with the Federal Reserve.

But it's amusing to me, at best, when you see the wheels come off in one day's trading and when you see credit volatility go through the roof and the yield on the 10-year US risk-free rate (the benchmark for the entire world) crash.

And that's not an exaggeration.

Pushing the inversion of the yield curve to its most acute when all of the best-laid plans among central banks was to do this cute little one-quarter percentage point rate cut that would elegantly un-invert the curve.

And then they could get together and put their translating headphones on that they borrow from the UN and sing “Kumbaya.”

It doesn’t work like that. And I’m sure Peter would agree with that.

**Peter:** Yeah. Essentially the Fed is sort of winging it. And they’ve been winging policy for a while. So, for all the PhDs that they have there and all the models that these PhDs create, there is a sense of winging it.

And I think Powell and others realize that, because they stopped raising the rate at the 2-1/4, 2-1/2 level – and Danielle said earlier they wanted to get to 3 – they realized they only had nine rates to cut, assuming that they would have actually wanted to go back to zero again (which is a separate conversation).

When you have nine rates to cut, you have to be very judicious with those nine cuts. And I think Powell also is feeling an extraordinary amount of pressure from Trump.

And you can have Fed heads write articles, or independents. We block out the noise, this and that. But there is still an extraordinary amount of pressure that he is responding to, not really to cut rates because of Trump.

He still sees the weakness overseas. He sees the weakness in manufacturing. And he’s saying to himself, okay, you know what? I can cut rates here and then we can stem that weakness and create a firewall before it spills over into the consumer side of the economy and everything will be fine.

And I think that’s how he viewed this.

In his mind, if this is (quote unquote) due to global developments, which is outside of his purview and outside of his influence because of the trade and manufacturing nature of the tariff-induced slowdown, and he’s hoping if I can cut here and then maybe we can get a trade deal and everything will end up being okay, then he can somehow skirt by this.

But then, of course, he’s getting dragged in every direction by what other central banks are doing.

And the key question from here is (and Danielle has heard me say this) does he get caught in this peer-pressure vortex of going down the same path of the other central banks in order to keep up and satisfy what their models say – which is, very simply, *rate cuts good, rate hikes cuts*



*not good.* Where does he stop?

To me it's not a question of, okay, is he going to cut here, is he going to cut there?

But where is the end game for Powell, at some point?

Let's just take this further over the next 6-12 months that the economy slows down. That Services start to weaken. And we begin to see layoffs. And consumer spending gets hurt. And the stock market falls. Where does Powell take us?

Well, in speeches he said, yeah, it's not a question of if we go back to zero. It's when.

And then he talked about – I don't know if it was a Fed press conference or a speech – yeah, there are plenty of Treasuries out there for us to buy.

So he's told us that, yeah, he's going to go down the road of the BOJ and the ECB.

But he's going to also learn the hard lesson that it doesn't work. And it's not going to help. And you're potentially damaging your banking system.

And you have this situation where the stock market is going to continue to rely on your rating cuts, but then when they finally realize that it's actually not helping spur extra economic growth, you're going to be back to that pushing on a string, and then central banks are going to have nothing.

But the Fed has an opportunity to learn the lessons of what other central banks have done. And the question from here is, Are they going to learn those lessons?

Because the odds of a soft landing are slim. Historically, they've been slim. They've only been achieved about 20% of the time. And I would say the odds of a soft landing this time are much less.

And is a central banker with the president tweeting and breathing down your neck willing to Volt cross the Fed and say, You know what? Our rate cuts aren't going to do any help and it's just going to get us trapped like other central bankers are going to do.

Or is he just going to fall for the same trap that the others have?

**Patrick:** Moving on, I wanted to go back to that statement of a mid-cycle adjustment. Because, assuming it's a mid-cycle adjustment, then all of the economic slowness we have here should be very moderate and we should see everything start to pick up on the other side.

Yet we're seeing a potential global manufacturing recession starting and a potential earnings recession starting. Everything is starting to weaken.

In your minds, is this just a modest slowdown that will recover? Or is this something that can morph into a much bigger economic recession? What's your take, Danielle?

**Danielle:** Well, I think that if we don't fall into recession that I'll have to (excuse the pun) I will have to trump out that phrase "It's different this time." And I'm remiss to do that.

What I would point to, though, is the very slow degradation that we have seen in the creation of high-paying jobs. And this is something that peaked out last fall. And it has slowly but surely been coming down on a monthly basis to where the bulk of the job creation that we're experiencing now is in what we call low-paying jobs. Eat, drink, get-sick categories.

And that's not going to help propel the economy forward.

One of the data sets that we pay close attention to, that I've spoken to before, is the Challenger Gray & Christmas data. What started out with Challenger & Gray was basically a retail story that made everybody's eyeballs roll into the back of their heads.

But what we noticed getting into 2019 was that we were starting to see, not just automobile and industrial layoffs kick in in a big way, but we started to see that in information technology and transportation. And more recently, even financials. And we're seeing a lot of the big banks announce layoffs.

So if you see the movement from the *Gee, we can ignore the 11% of the US economy that is manufacturing*, if you see seepage into the services sector, which is exactly what we're seeing – we've had eight or nine trucking companies go bankrupt so far this year.

That is a services sector that happens to have led the entire economy in 2018 that was one of the recipients of all of the panic buying ahead of the potential increase in Chinese tariffs.

When you start to see the bleed from industrials into that 88% of the US economy that is services, then, barring some kind of fiscal stimulus measure, I think – as Peter said several times – it's increasingly apparent that the Fed is pushing on a string.

If we don't get something from Washington, I couldn't throw the probability out there of getting an infrastructure bill, say, before the election – dot, dot, dot, NOT –

If we don't get something of that ilk, I can't see a pathway for the economy not continuing its slow slide into recession.

**Patrick:** Peter, where do you stand on that view?

**Peter:** I think what will be the determining factor of whether this is going to be just a normal recession – when I say normal, somewhat being mild without any crazy exogenous

effects – versus something that will be deeper, where do house prices go?

If you look at the consumer right now as the strongest part of the economy, but of course showing vulnerability – If service is weakening and we see a slowdown in hiring – We saw a slowdown in hours worked in the last payroll numbers –

If all of a sudden the stock market stops getting the benefit of, *oh, the Fed is going to save me*, and it actually starts to really correct, not just have your V-bottom that we've seen countless times over the past 10 years, but a selloff on the stock market that lasts, a selloff in real estate prices that lasts, and a widening of credit spreads that starts to impact the financing of small- and medium-sized business, that's where you go from a mild recession to something deeper.

We have to remember the last two economic recessions were really exaggerated by a decline in asset prices. The decline in tech stocks led to a collapse in CapEx. And, obviously, the decline in house prices led to a collapse in bank balance sheets.

And then it went from there.

To me, we have still this asset-price-dependent economy that affects not only the psychology of its participants but also the financing of the Beyond Meats and other venture capital businesses.

So where that goes in response to this economic slowdown, I think, is going to be a really important determinant in measuring the extent and the deepening of any downturn.

**Patrick:** Erik, do you have anything to add to that?

**Erik:** My perspective is a little bit different, because what I think about the most is, first of all, a recession has to be coming. Because you can't go forever without having one. It's been 10 years. We're overdue.

It's beyond my paygrade to say whether that happens right now or next quarter or the quarter after that. I'll be very, very surprised if we get to the end of 2020 and there has been no significant recession.

I think it's much more likely that one has already begun and we don't realize it yet. But I don't claim to be able to time these things. That's past my paygrade.

What I think is much more interesting to think about is, Will the next recession be the catalyst that triggers what Ray Dalio calls a paradigm shift?

For anyone who is not familiar with Dalio's writings on the subject, what Ray has predicted is we're in a paradigm in markets now where central bank liquidity has been holding up asset prices and it's been working. And that cannot go on forever. It will stop working. There will be a

loss of confidence in the system. And it will eventually reverse to the point where central banks are completely unable to support asset prices with printed money.

And, at that point, the whole name of the game changes.

And even Dalio, who is one of the most respected money managers in the world, said it's beyond his paygrade to know when that's going to happen. But he's convinced it's coming in the next few years.

And the big question in my mind for the next recession is, Will that recession be the trigger that sets off that paradigm shift that Dalio is talking about so we get into a regime where suddenly central banks are no longer able to support asset prices by conjuring money out of thin air the way they have been for the last 10 years?

I don't know the answer.

But, to me, that is the most important thing to watch for as we get into the recession, which I'm confident is coming probably within the next year.

**Peter:** Well we've reached that point overseas. The Nikkei is down almost 50% from its peak. The Topix bank stock index is down 90% from where it was 30 years ago. The Euro Stoxx 600 is below where it was in 2007. And their bank stock index is down 80% from where it was in 2007.

So, outside of the credit markets, those banks have already lost control of their equity markets. Not that they have the same reliance on stock prices that we do here, but it's proven there to not have worked. And at some point (to your point), and what I believe will be eventually here, is the Fed will lose control of our stock market. Which will then determine how deep that recession goes.

**Erik:** And that's where you want to own gold and a lot of it.

**Peter:** Correct.

**Danielle:** I think, right now, this conversation can take a turn towards the societal implications.

I think what you were starting to get at, Erik, the societal implications of Fed policy and what it has produced and where there might be resistance in the coming years, given some of the comments that Dalio and people like Stanley Druckenmiller have made recently.

**Erik:** Danielle, you hit the nail on the head. I think that's exactly the place to go next.

And one of my predictions is it's not just how central bank policy will affect the social mood but

it's also how the social mood will constrain the ability of the Fed to act.

And one of the things that I predict is that, when we get to the next significant market crisis and the Fed really does have your back – the Greenspan put is still there, central bankers do intend to save markets.

And then, suddenly, there is a 10 times bigger than Occupy Wall Street uprising of the people that says,

*Hell no, no more bailouts for Wall Street. Let the stock market crash. We're sick of bailing out the bankers. If you're going to print money out of thin air, give it to us. Use it for universal basic income. Use it for forgiveness of student loans. Use it for whatever other social spending program.*

And I think there is a rapidly growing support for that.

So I don't think it's just the central bank policy affecting society. I think it's society, potentially, tying the hands of central bankers in their ability to rescue markets.

**Peter:** Erik, I agree with you. If you listen to some of the Democratic debates that we've seen, a few times I've heard people talking about, well, yeah, the stock market is up but not everyone owns stocks.

And I think the politics around more QE and going back to zero to lift asset prices are going to be a lot more difficult for the Fed from the Democratic side than they've ever experienced before.

**Erik:** I completely agree. Danielle, what's your take?

**Danielle:** I have some very deep thoughts and feelings that have been triggered by a recent interview that Stanley Druckenmiller gave to CNBC in which he said that Fed policy has been fantastic for rich people. And that (quote unquote) this is the biggest redistribution of wealth from the middle class and the poor to the rich ever.

I don't think that he's only speaking for his billionaire buddies. But I think, rather, he's speaking for the 99% who are quite certain they've been left behind.

And the governor that I see on Fed policy that has not been as much of an inhibitor, if you will, to the European Central Bank to the Bank of Japan, to the People's Bank of China, the biggest governor I see going forward is that –

Because there is so little ammunition (to Peter's point, we started out with nine bullets in the chamber, not a lot compared to prior cycles when we've had over 5% points of ammunition) –

But what happens if, let's just say, the Fed gets to the point of needing to launch quantitative easing (or feeling that it needs to launch quantitative easing)?

We know it doesn't work, so why go there?

But what happens if they get to the point, if the Trump tweets – Trump has already started tweeting about quantitative easing – the volume is just going to get higher and higher.

But can you possibly see, in this world of rising populism and this feeling that we don't need to bail out Wall Street but we need to bail out Main Street, can you imagine what happens the next time the Fed announces quantitative easing?

It just doesn't want to go there.

I think they will have the wrath of Congress descend upon them almost immediately, demanding that the proceeds of the Fed's printing press not buy Treasuries that benefit the banks and the banking system, but rather that they fire up the printing press to pay for X, Y, and Z for the little guy who was left behind during the decade of unconventional monetary policy that clearly only benefited the fat cats on Wall Street.

That's going to become extremely problematic, even for the crowd that is clamoring for the Fed to print money for social relief, because of the effect such criticism and such skepticism would simply have on the stock market and on the credit markets.

And these are the dots I don't think people are connecting.

Erik, Peter, I'd love for both of you to tell me how you think risky assets would react if QE was announced but it wasn't going into Treasuries.

**Erik:** Oh, I think it's coming. I think, actually, QE will be announced into Treasuries. And it will not actually be implemented because, before they have a chance to click the button, they're going to have a revolt from the political left.

And the political left is going to say, look, you need to use any printed money for the things that we want to use it for, which is social spending and universal basic income and so forth.

And what's going to happen is the policy-makers at the Fed and the political right are both going to respond and say, wait a minute, wait a minute. You guys don't understand this stuff as well as you think you do.

You see, we're smarter than you. And we know that the way you want to do it would be really inflationary. And the way we want to do it is not so inflationary. And you should trust us because we know better than you.

And the political left, which is going to have the majority behind them – and, frankly, I think they should – it's not my personal political belief, but I think they would make a very good point.

Which is, hey guys, we've tried the business of trusting the political right and their politicians on what the policies should be. No thanks. We're not interested in that. We want to do it our way now.

And I think that the popular response that they would get would be unstoppable. Regardless of whether policy makers want to do it or not, they would be forced to do it.

And I think that we're very likely headed to some incredibly inflationary and, frankly, reckless policy decisions ahead of us, not because the policy makers want to make those decisions but because they won't be given a choice. The political pressure will be so strong that there will be no possible way to oppose it.

That's my take.

**Danielle:** So, Peter, I'll put you on the spot here. Let's just say Erik's scenario plays out.

How do you think the frothy, leveraged, loan junk-bond investment grade-bond stock market –

How do you think risky assets would respond?

**Peter:** Well, it would be a problem.

If Erik is right and it does lead to higher inflation – because when you look at QE, QE is just a central bank asset swap. But if QE is going to be used not to buy Treasuries but to basically hand money out to people, the inflationary implications then have a direct influence on where bond yields go.

Bond yields will then rise and then squeeze every company that's too leveraged because you're going to have a stagflationary type of environment with shrinking cash flows and higher inflation and rising interest rates.

And that's a nightmare scenario.

**Danielle:** I'm not able to poke either of you into giving me the answer I want, though.

Everything you said, Peter, and everything you said, Erik, all makes sense.

But what happens if the beneficiaries of the Fed's next round of QE, what happens if the beneficiaries are not the markets? And the markets fall out of bed and you have everything that Peter described, with inflation and rising interest rates. But at the same time layoffs and

unemployment go through the roof?

**Erik:** Danielle, I think you get, ultimately, an inflationary depression. At least, that's the potential risk.

And the way that that would come about is we have dual bubbles in both the stock market and the bond market. And everybody assumes that they can't both burst at the same time.

But if you suddenly had the realization in the marketplace that, hey, the Fed does not have our backs anymore – they can't, they've been politically outvoted.

And all of a sudden they're not buying Treasuries.

You've got a potential to set off a trigger for higher bond yields. Not just for the reasons that Peter just described, which were all excellent, but also because there is, effectively, a bursting of the bond market bubble with a coincident burst of the stock market bubble.

That in turn forces a systematic unwind of the massive institutional risk-parity trade because, all of a sudden, that correlation ratio that that trade is based on stops working.

And you have a massive meltdown along with much higher bond yields, runaway inflation.

And the thing about all this is inflation has a lag effect. At first it will appear that the policies are working beautifully. The handouts are very popular. People love having the money. The inflation doesn't start on Day One. It seems like everything is great. There is a jump for joy and a celebration and let's do even more of it.

Eventually, when the inflation catches up with the economy and you have out of control bond yields and suddenly the US government cannot service its own debt, even apply 100% tax revenue to servicing its debt, you have to raise taxes in order to service the debt. And you can't because you're facing a stagflationary environment where nobody can afford more taxes.

You've got an absolute crisis on your hands.

And I think that we have all the ingredients.

Certainly, not that those things all happen overnight. But we have the ingredients for a social spending program where QE is used, as Peter described it, for handouts.

And it works beautifully at first. It seems like it's working. They do even more of it. And, eventually, you get to a point of no return where there is this snowball effect and you can't stop it at that point.

And that's what I'm afraid is the worst case that we may be headed to in the next decade



(certainly not in the next year or two).

**Patrick:** Erik, I think there is a solution for that. At least it's been proposed. And that's MMT.

I'd love to move on to this topic and get everyone's opinions about modern monetary theory. Let's start it off with you, Peter.

What's your impression? Is this something that's in our future?

**Peter:** Well, I feel like we've sort of been living it right now, in lower doses compared to what some proponents of it talk about. But certainly in Japan you can argue that we have been living it for years. And we can see clearly what the results are.

And Europe, you can argue, and, in some ways, here.

You take it one step further and to the point of whether it can be contained so that there are no side effects.

Well, that assumes that there is an unlimited supply of things where MMT is the demand driver of things.

But, once you get into a situation where people realize that excess demand created by MMT, where money is just handed out to people, needs to be fixed demand of supply or more limited supply, then you get into a dangerous inflationary situation.

And everything unfolds the way that Erik just talked about. And the bond market revolts and takes away this printing press and takes away this option of a government.

When you think about all this easing that we've done –

Okay, you originally had easing. It doesn't work. And then the government response is let's do more easing. And that doesn't work.

So MMT is then the next doubling down because all the monetary stuff on its own didn't work, so let's combine that with a fiscal push and then we'll really get to where we want. But that will fail as well.

And, getting back again, what will eventually call it out and eventually end all this revolting to the inevitable inflation that MMT creates.

**Patrick:** Danielle, what's your thinking on MMT?

**Danielle:** Well, I think MMT is – not to make any enemies here – but I find MMT to be amusing to the core. Namely because, when inflation rears its ugly head and, presumably in a

situation in which MMT in the United States was being pursued, it would be running (to Peter's point) in hyper-drive in other countries.

So there is this assumption that, as long as you've got a printing press, and you're issuing debt in your own-denominated currency – thank you, Christine Lagarde, isn't she coming on at the right time?

Eurobonds – there is this idea that all of the countries with printing presses, China included, can carry on with their own MMTs in isolation, until which point you reach a debt-to-GDP level that triggers inflation.

And here's the amusement factor: Once this inflation is triggered, you simply fix it by levying higher taxes on those who can pay.

Now, I think we're still talking about a United States of America with a Congress. And the need for Congress-people, when inflation is going haywire, to come in with tax hikes.

I don't see the political will or wherewithal to resolve the challenges that MMT will present via rising inflation by increasing people's taxes, kicking them while they're down, if you will.

You'll have billionaires simply get up and leave the country. And millionaires.

If that level of socialism was to be imposed.

Along with what we spoke of earlier, what would be required of having the Fed be the conduit to print the money to solve all of society's woes?

And something else that would come into play here – and this is a huge debate that I recently launched on Twitter –

Let's just say, theoretically, that Wall Street is not bailed out and therefore the stock market and the bond market fall out of bed. And that might or might not take down a few states such as, oh, I don't know, New Jersey, Illinois.

With it the pension systems fail.

Can MMT therefore just be deployed to make sure that we don't have pensioners with no pensions? Can MMT theoretically just be used for whatever ails the economy?

Fill in the blank.

And the answer was...

(Of course, this is via Twitter and I'm poking bears on purpose at this point.)

But the answer was, you have a fundamental misunderstanding of what MMT is. MMT prints money in order to raise people up together.

To which I replied, well, what happens to those who are falling down because of it?

At which point we came to a stalemate. And I pretended to be stupid and moved on.

**Patrick:** Erik, do you have anything to add to the MMT storyline there?

**Erik:** You know, just to build on what Danielle said at the end there, my view on MMT is it is one of those very interesting things where I do not think that it is possible for any person – and I include myself in this criticism – to separate their own political ideology from their opinion about MMT.

You take a guy like Professor Steve Keen, whose whole story is entirely about *there is too much debt, and debt is the enemy, we've got too much debt*.

But Steve describes himself – these are his words, not mine – as being politically just left of Nancy Pelosi. And, despite being a total anti-debt guy, Steve is a big proponent of MMT. He thinks it has a lot of value.

I will be the first to admit my own anti-MMT perspective is based on what are admittedly political beliefs.

I don't think that you're doing anyone any favor by giving them free handouts. I don't think that it is beneficial to society for there to be free college tuition. I don't think that's a good thing. So I'm against MMT.

But, Patrick, I admit that my political ideology is influencing my opinion.

And I don't think anybody has an unbiased opinion on MMT. Everyone is biased by their own political philosophy. I think it affects the way that people think about this.

And it's scary because MMT is going to be a really, really big deal.

And I think all of the people that – and this is probably a criticism that applies to the way most of our political policy-making occurs – all of the people involved in the decision-making are going to be making emotional decisions based on their own philosophy, as opposed to really looking at the hard facts of what works and what doesn't work. And what the cause and effect of various policy tools are in the economy.

**Danielle:** Erik, if I could jump in, I'm going to challenge you for just a minute. I think that if you look at the Scandinavian example of pockets of MMT already having been deployed, and

see that the people who are on the receiving end of MMT-type policies are decidedly happier, but at the same time the employment situation has not improved in the least, I think you can look at MMT agnostically and apolitically.

And determine that, if it's not going to generate a longer term higher economic growth trajectory, that, in and of itself, it should be abandoned.

Because the MMT philosophy is that this will raise all boats by making people happier and, therefore, more willing and able to succeed and provide their own whatever it may be economic input into the longer-lasting better growth rate for the country – which some MMT experiments are already proving not to be the case.

**Erik:** Well, Danielle, my hat is off to you. If you are able to be completely agnostic about MMT, then I think you are in a very small minority.

My opinion is that most of the people who claim to be agnostic really aren't. They have beliefs about what is socially appropriate, what we should be trying to accomplish socially. And I think that most people's opinions are biased by that.

And I certainly admit my own opinions about MMT are biased by that.

If you are able to be so intellectually disciplined as to stay completely agnostic and not allow your own political philosophy to enter the equation, my hat's off to you. I wish I had the same ability.

**Peter:** And also it gets to, Do you believe in the effectiveness of the actual implementation?

Because somebody has to implement this. Someone has to make the allocation decisions about where this money goes.

And, getting to your point, Erik, about the politics and what people think, yes you have more of a tendency to believe in it if you are those people of a political ilk that believe in the capabilities of the government.

Those that question the efficiency of government, generally speaking, are obviously going to be more suspect of this policy, particularly in the implementation phase.

**Danielle:** Yes. And, Peter, to your point, if you could imagine just one itty bitty example of MMT, which is obviously a large one, is Medicare for all. There is an underlying assumption that the federal government can be an efficient arbiter of health care in America. I don't know of an efficiently run American agency in existence.

**Peter:** Right. And, getting to my point earlier about, okay, we are going to create all of this

demand for things through MMT, but no one is talking about what the supply is.

I mean, let's try to figure out how many doctors are there going to be left if we have Medicare for all. And that a procedure for an hour is going to cost \$26. Doctors are going to be falling out of the system by the wayside. Hospitals are going to go out of business.

So, in that debate, no one talks about what's the supply response going to be when all the money is then thrown on the demand side?

**Danielle:** That's exactly right. In fact we've seen a taste of that with what has come across, just with Obamacare.

I personally have lost three doctors who have gone off to become concierge services because they simply couldn't make enough of a profit, given malpractice insurance costs, to make it worth it.

**Erik:** Danielle, I'm just going to come out and say it.

I think that, in many ways, your comments are actually revealing my point, which is, if I listen to you and Peter talk about this, it's clear that your philosophy – you've just said you've never seen a successfully managed government organization. You have a set of beliefs about the value of government.

And I'm sure if we had an MMT proponent here, they would have a different view. They would think that government is capable of doing all sorts of wonderful things and people like you just need to get out of the way and government can do all sorts of fantastic things for everybody.

Your political philosophy, and your (as Peter put it) inclination to believe that government is the solution to a lot of problems strongly affects whether or not you buy the whole MMT story.

Take a guy like Steve Keen, who is absolutely brilliant economist. I'm sure he could make a very credible-sounding argument for why MMT really could work and it could solve these problems and we wouldn't have the issues with health care.

And, frankly, I know that I'm biased by my views. I don't believe in handouts. I think that Steve's own description of himself is a very left-leaning guy. In my opinion, that explains a bit of why he is such a believer in MMT. (I certainly don't know that he would say that, but that's my impression.)

So I think it does affect all of us.

**Danielle:** Fair point. I'll take that.