Summer Special Part 2: Danielle DiMartino-Booth and Peter Bookvar on the Future of Monetary Policy

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Patrick: Okay, so I want to move on now to talking about inflation and deflation. And I know Peter and Danielle, you've both spent a lot of time talking about this between the two of you and have different views on what are the risks and where things are going.

So let's start with you, Peter. What's your feelings about inflation and where we are in the market? And what are really the risks moving forward with inflation and potentially even deflationary risks?

Peter: Most people, and central bankers in particular, they look at inflation as black or white. Either going up or it's going down. There's either inflation or there is deflation.

And I believe that inflation is really in the eye of the beholder in that you can argue, okay, take the quantity of money that central banks have created. Well, that's highly inflationary. But where does it show up?

Well, we know that there has been, obviously, massive inflation in asset prices, epic inflation in credit markets. And then, on consumer prices, there's been more muted inflation.

But even within that, what do you look at? Do you look at CPI or do you look at PCE? Do you look at the PCE or do you look at Dallas Fed trimmed-mean PCE? Do you look at CPI or the Cleveland trimmed-mean CPI?

Well, each of them measure different things.

The PCE, the biggest component, is health care. Well, health care, that's measuring Medicare and Medicaid reimbursement rates which are artificially suppressed and priced lower by the government. Well, should that be a good inflationary gauge?

If that's low, does that tell me that inflation is really low?

Or should I look at CPI where health care is a smaller part? It's actually measuring out-of-pocket expenses.

Dig deeper. Inflation is services on one side and goods on the other side. Well, ever since in the history of the world when we've had progression of technology, there have been goods that are deflationary. As things get more technologically advanced and get more efficiently made, there is a natural downturn in pricing. Well, that goods deflation.

To me, inflation is more of a cyclical event where you see a rise in goods prices that sort of matches up with persistent services inflation. And then you get a slowdown in inflation when you get the reverse – you get a decline in goods prices.

Because you rarely see much of a decline on the services side of the inflation equation if you're measuring health care correctly, it's not like the government does a [INAUDIBLE WORDS] PCE.

So from here on out, to me, what happens with the goods side in response to the tariffs is going to be a key thing.

Who's going to eat the tariffs? Is it the Chinese that are going to eat the tariffs because they're going to lower prices to US importers, which they'll be able to offset by a weakening currency?

Or are they going to be limited in that. That will leave the US companies literally paying the tariffs to then try to offset that by higher goods prices in the US. And then you would join that with services inflation. And then you all of a sudden have inflation that's higher than what people are anticipating. So that's the key thing, at least right now.

Where do the goods prices go from here in response to these tariffs? Who is going to be able to eat it and who is not going to be able to eat it? Who is going to have success in passing it on and who is not?

In the past, you have some companies like Walmart that said they're going to do everything they can to pass it on. There was a furniture company in the ISM [Institute for Supply Management] the other day that said, yeah, they're passing it on to everyone that they can.

I listen to a lot of conference calls. I talk to a lot of business people. And everyone is trying to figure out a way to pass it on. And it's not all being eaten by the Chinese.

So I'm worried that – yes, we've seen this drop in the recent inflation trends but we're still running at around 2%. The Dallas Fed trimmed-mean came out a couple of days ago. It's right at 2%.

So this obsession with getting to 2% – and you look where monetary policy has been driven by whatever number they happen to look at. If CPI and PCE never existed, monetary policy might be quite different.

So, to my point also, it's in the eye of the beholder, how you analyze it, where the inflation ends up showing up, and also how you react to it.

And then one last thing, we talk about inflation expectations. We look at the inflation break evens. And inflation break evens are just highly correlated to the price of oil. So you have in every Fed statement the Fed talking about inflation expectations, and really it's just tied to the price of oil and other commodities.

Patrick: Danielle, what's your impression or counterargument to Peter?

Danielle: Well, again, Peter and I are not on opposite ends of the spectrum. I focus on the core PCE, appreciating that the core PCE that the Fed uses is, as Peter explained, broken. And even when it does measure that other great big line item in a household's budget, housing costs, also understates it.

I nevertheless focus on the broken metric because my former colleagues at the Federal Reserve refuse to focus on anything remotely closer to reality.

And the reason I do focus on the core PCE is because, as long as it's going to drive Fed policy, it's what we have to pay attention to.

Would I ever dare tell my retired mother that inflation is running too low? Not if I was within hitting distance of her because she would slap me upside the head and say, what have you been thinking? I thought you were supposed to be some kind of an expert on these things, dear. Of course inflation is not low. It's staring you in the face everywhere as rising at too fast of a clip.

But, again, because of what I think is happening with the housing sector in particular – and I've written extensive on the subject – when you start to see things like the rate of home price appreciation has come down for 15 or 16 consecutive months – again, it's still an appreciating rate of home price gains – but it is coming down.

And once it starts to approach that red line and go negative, then the Fed is all of a sudden going to think that it's got a DEFCON 1 situation on its hands, that inflation is so low and that it doesn't look like it's going to be transient or transitory in nature, and therefore they really need to do something to get out in front of it.

And when the doves really start to cry – again, if we're in the midst of what I think is unfolding, which is a slow-moving pathway to a recession, then the fact that mortgage rates have come down and we haven't seen the transmission mechanism of lower rates spur a fast enough degree of purchase application activity –

We've seen a ton on the refinancing side, but we really haven't really seen what we would expect in terms of home purchases. In fact, pending home sales were rising the most on the West Coast where home prices are falling at the fastest rate.

My point is, if we start to see the stickiest form of inflation flip into deflation – If we start to see home prices come down outside of just California and we're seeing weakness in the New York area as well – and Peter has written extensively about the salt states and the fact that there is this exodus out of these states with high-priced housing – if you continue to see home prices come down and even fall into negative territory, I fear for the overreaction on the part of those on the FOMC as they react to this.

Because it's the last thing that people need is even lower interest rates when it's not the medicine that's going to cure the patient.

Patrick: Erik, do you have any insights to add to that?

Erik: You know, the question of when secular inflation comes back into the economy is beyond my pay grade. I'll leave it to Danielle and Peter's greater intellect to tell me when that might happen.

What I do want to comment on is what's going happen when it does happen, whenever that is? And this is really a story about preparedness. You know, one of the things that a lot of people have said is, when we do get into another financial crisis situation, we have to be really careful.

Because there is a whole generation of professional traders now working in institutions that came into the industry after 2009 and have never been through a bear market and don't know what it feels like and don't know how to navigate it because they've never had that experience.

Well, we have an entire industry which is categorically not ready to deal with the onset of secular inflation. The last time that happened was 1972.

People who were working in the industry in 1972 have been through this before and they know what it was like. You've got to be upwards of 75 years old to be in that category.

That means that everybody who works in finance read about this in a book in college and forgot about it years ago and has never been through it.

It means every economic advisor to the government read about it in books and has never actually been through it themselves. So when it happens we're going to have an entire system that is completely unprepared for it.

And I think that the nuance between just straight inflation and stagflation, which I think is much more likely, is going to trip us up and a lot of people are not going to know what to make of it.

Imagine a trader who has never been in a bear market before suddenly being confronted with one. We've got an entire industry and an entire political system that has forgotten what the onset of secular inflation is like.

So when it comes – and I have no idea when that is – we are not ready.

Patrick: Peter, Danielle, any comment on that?

Peter: I agree. And also it gets back to when you think about the bond bubble that central bankers have created and then they root for higher inflation that would implode the bubble. God forbid we get that higher inflation scenario.

Patrick: So I want to move on now to talking about financial repression and this idea of global debt. Because, you know, when you look at some of the numbers coming out showing the $250 trillion of global debt out there, the massive growth in the global debt as a percentage of GDP, the $13 trillion of negative-yielding debt that exists out there, we get to the scenario of how do governments deal with all of this debt?

And of course you hear a number of doomsayers that'll come out there that idea that governments just explicitly default on this debt. Or a very common one is that they'll just inflate the debt away.

But what we are currently experiencing, in my view, is that a period of significant financial repression – this idea where they keep these nominal interest rates lower than they would otherwise prevail to reduce the government's interest expense, contribute to their deficit reduction, and a way of actually potentially liquidating the debt by repressing, creating negative real yields on interest.

And so this is where I wanted to sort of talk about how does this play out? Because repression does need bursts of inflation.

But we were talking about this idea of they have been suppressing interest rates. And, Danielle, I know you've talked about the fact that they've changed the language from zero-bound to effective lower-bound. And this idea that we are going back potentially to zero interest rates. This is where I want to go.

So, Danielle, what is your thinking of the change in the language in the Fed? Are we going back to zero? Is financial repression still a reality over the next few years?

Danielle: I think if we could be a fly on the walls of the Eccles Building, at the Federal Reserve Board right now, there has to be a tremendous amount of furious debate – I mean we're talking about academics gone wild here.

Because the idea of negative interest rates works as long as there is one great big country with a reserve currency status that still has positive interest rates that makes all financial modeling on Planet Earth, that gives every other country access to positive interest rate financing that allows some aspect of the global financial system to remain on solid footing.

I'm not sure if the PhDs at the Fed can wrap their heads around this, but I can tell you Jay Powell can. He understands this dynamic.

What happens, for example, if you put a negative interest rate into the Black Scholes interest pricing model, it will tell you that that put or call's value is infinity. All of the models collapse under the auspices of negative interest rates.

The reason it's worked offshore, the reason the academics have been proven to be brilliant and correct, is because of the United States standing firm and having positivity in our interest rate structure. If that falls apart, you're talking about the collapse of the banking system of the United States.

Go back to Peter's comment that Japanese stocks are down 90% from their highs. This simply would not work in our system. We would have to go back – and to borrow my buddy Jim Bianco's characterization – we would have to go back and recreate the banking and financial systems of the United States from scratch under a negative interest rate regime, simply because the rest of the world would lose an outlet, a conduit through which to find relief from their own negative interest rates.

Patrick: Peter, what's your take on this all?

Peter: I've looked at negative interest rates as just being poison because it's a tax. It's a tax on capital that somebody has to eat. And right now the banks are obviously eating it.

But now you have a situation where UBS [Union Bank of Switzerland] is going to start passing that on to their customers. The customers are now going to be penalized for depositing with UBS. And as long as it's a tax, it's going to drag on capital.

Because it's costing money every year – and some estimates are $7-8 billion. That doesn't sound like much on an annual basis, but considering that it's been going on for five years now, European banks and Japanese banks are bleeding capital.

Plus you then destroy your yield curve. You essentially kill your bond market. You're not going to get faster growth. You're going to get a contraction. And if the banking system is supposed to be the transmission mechanism of this policy, then you're bleeding to death the transmission mechanism.

So I would argue that the BOJ and ECB are now running a restrictive policy, and have been ever since they went to negative interest rates.

And I agree with Danielle that it would be very difficult even to pull off here because the US money market industry is $ trillions plus. You don't have that sort of equivalent in Europe and Japan. You would destroy the money market industry.

And that alone would cause such a credit crunch – and then all of that commercial paper out there – that you would immediately go into a recession. So I just don't think negative interest rates is even close to a possibility.

In terms of one of the things you mentioned early on about how government can default or not, well negative real interest rates is essentially default. As long as you're earning less than the rate of inflation, the government is chipping away at your wealth and your standard of living. And that is essentially a default. So governments have been defaulting for the last 10 years in terms of the money that they owe their lenders.

So I'm very much against negative interest rates and I think we're going to look back and say it's the dumbest economic policy in the history of economics.

Patrick: Erik, do you have something to add to that?

Erik: I'll draw a really crazy analogy because I think these are absolutely historic times and I think that most people are not recognizing how historic the events of the last few years have been. And I think we'll look back at this period in history and just say, oh my gosh, I can't believe that such significant things happened and I didn't even realize at the time.

My crazy analogy is this: *We hold these truths to be self-evident, that all men are created equal, that they are endowed…with certain unalienable Rights, that among these are Life, Liberty and the Pursuit of Happiness.*

Those words were written and signed by slave owners.

But at the time it didn't feel hypocritical or ironic to anyone that the white men who wrote those words owned black slaves as property. Because at the time that was just considered normal and they didn't think it really contradicted what they were saying in the constitution.

And I think we've gotten to this point where everybody is acting – it's sort of like the frog boiling in water thing. We've gotten to this point where everybody in finance, at first there were the people that said it's impossible, you can't have negative interest rates, that's not possible. And then we've got them and it's, oh, I guess it is possible, okay let's move on.

People are not, in my opinion, really absorbing the historic, profound significance of this. And particularly we have economists who are in positions of advising governments saying, look, we need negative interest rates because we need to stimulate the economy and get people spending again.

So all those values that we were brought up with as kids, like save some money for a rainy day. And savings and investment is prudent, responsible behavior that makes society a better place if everybody takes care of themselves.

That's out the window.

And it's like, look, we've got a whole bunch of people that are acting intelligently and not spending what little money they have, they're saving it. We've got to do something to force them to spend it for the public good of everybody.

That is so absurd. But that is the policy. That is the motivation that's leading us to negative interest rates because policy makers believe it's a necessary step to stimulate spending.

And I think it's just as absurd as slave owners signing those words in the constitution. It doesn't make sense.

Patrick: What I wondered, though, is, okay, you're suggesting that in that one angle. But what I look at is that – it's that Luke Gromen argument that we've heard, which is it's the interest that it takes to service the outstanding debt and that cross-section of when the US Federal tax revenues simply won't be able to even service that interest on that debt.

The idea of suppressing interest rates is not about necessarily being a stimulant but it's even just about the idea that the government can continue to function this way.

And then this is obviously where MMT comes in in some degree or another.

But how much of that is, in your mind, the current trend to much lower interest rates? Is it not just about the ability for governments to service their existing debts?

Erik: Well, Patrick, I didn't mean to end there. I think that we're in incredibly historic times. And we've gotten to this point where we have to realize, as Danielle said earlier, the entire design of the financial system is based on these academic concepts like risk-free return.

Well, now we've got a risk-free premium, the tax, as Peter described it, of holding risk-free assets. And it does create a cash-hoarding incentive.

There is a risk of a run on the entire fractional reserve banking system if negative interest rates get negative enough to incentivize people to hoard cash. All sorts of things could go wrong that have all kinds of system risks. And I think that they're under-appreciated.

But I want to leave it to Danielle to opine on this. Daielle, what's your take?

Danielle: Well, you look back to the #1-selling household item in Japan – and I know Peter is laughing right now – but the #1-selling household item in Japan when negative interest rates were first imposed were household safes.

So this starts to bring on the discussion of cryptocurrencies and capital flight and discussions that you would think would be centered in a third-world country.

This whole idea of penalizing savers for holding money in bank accounts – and this is kind of the

Ken Rogoff school of thought – that if you insist upon keeping the money in the bank, you're only going to 97 cents on that dollar. We're going to give you a haircut. And therefore people take all of their money out of the bank and hide it under the mattress or put it in a safe.

Erik, to your point, you've actually inspired me. I'm going to have to go write about this. I'm going to have to go back and study my Founding Fathers, because this is a right. This is a right that we as Americans hold true, and we should hold true. And, to be pushed in one direction or another, I think would hopefully, hopefully get so much scrutiny by some politician that it would be prevented.

The only line that I could see drawn would be that of bankers and banking lobbyists saying, wait a minute, you can't do this.

On the other hand, I just don't know in the current environment any politician who would stand up for the banks, no matter how much money they threw at them, given the animus and given the fact that wealth has become so concentrated in this country that there probably wouldn't be anybody to stand in the way of pushing these through. Even though Janet Yellen said herself that she wasn't quite sure that the Fed had the authority to impose negative interest rates.

Erik: Hang on, I want to qualify what you said. Do you really mean that you don't think that any politician would support the banks behind the scenes? Or do you just mean in the public eye they need to appear to be not supporting the banks?

Danielle: Oh, absolutely in the public eye. I think that taking millions and millions of lobbying dollars from Wall Street is the way that the Beltway functions. I think that the Beltway itself would crumble.

Erik: So the politicians, we agree, are still working for the bankers. They just can't admit it publically.

Danielle: They can't admit it publically. But if we agree that modern monetary theory can potentially be launched, somebody is going to have to be on the losing end of this.

There are two parallel discussions that go hand in hand: negative interest rates and modern monetary theory. Modern monetary theory presumably assumes that borrowing costs are zero or, even better, that the government gets paid to borrow.

So you cannot have one run parallel without the other. You will not satisfy the people who are proponents of modern monetary theory and the bankers at the same time. It's impossible.

Patrick: I want to move on to the US dollar and talk about the idea of where the US dollar is going. Clearly, we've heard mixed messages from the administration where Kudlow and Mnuchin have been suggesting – or still supporting the idea of a strong dollar.

But, clearly, Trump is looking for the dollar to be lower and viewing a lot of different countries as currency manipulators, taking a competitive advantage on the US.

And then when we hear Kyle Bass coming out and saying that if the Chinese free floated their currency that it would be as much as 30% lower because of their current account deficits and fiscal deficits that are running over there.

I'm getting a lot of these mixed messages as to where the dollar is going next. What are your opinions on the dollar? Let's start with you, Danielle.

Danielle: I tweet out constantly #racetothebottom. And the thing about this is we're beyond a day late and a dollar short when it comes to labelling China as a currency manipulator. In fact, we're probably about 12 or 13 years late. So this is entering the realm of ridiculous.

If there is an area of the world where the currency has stayed surreally strong – and Peter has written about this extensively – it's Europe, where the euro is about 22-23% overvalued vis-à-vis the dollar.

But once these things get started – and this is kind of my bottom line on this – it is impossible to bring the train back into the station. Currency wars by their very definition mean that you don't have one shot across the bow that is not answered. Every move must be answered on the other side.

And I think that that is why, even in Beijing, following the labelling of currency manipulator, the authorities came out almost immediately and decided to back down from that seven handle on the yuan, so to speak. Because there are no winners in currency wars.

And as long as we have a 10-year yield that is positive and world investors say, Gee, should I invest in Greece or in the United States to get that yield? – there will be a rush into the dollar and we will be constantly fighting a losing battle in trying to get it to weaken. Unless, some way somehow, the administration thinks that it can recruit the Fed to work hand in hand with Treasury to weaken the dollar.

I just don't see that happening unless there is some way of making the Fed do this under duress.

Patrick: Peter, any comments?

Peter: I try to look at it against different currencies. And, yes, we've seen strong dollar rallies against the Turkish lira and the Argentinian peso and the British pound. And now we're seeing the rally against the Chinese yuan.

But the Euro heavy dollar index today is at 97.60-ish and change. Four years ago the dollar index is at 97.80. So the dollar index has really done nothing. It's obviously done nothing against the yen.

So where the dollar goes I think is going to be very idiosyncratic. If Brexit's not resolved, the pound is going to roar higher against the dollar. And I'm sure it's going to take the euro with it.

I think that the dollar certainly can continue to rally against the Chinese yuan. But I'm not so convinced that it's going to continue to rally against other Asian currencies.

The dollar itself has its own challenges. And whether that's exploding fiscal deficits that are now running $1 trillion a year plus – and God forbid where it's going to go when we go into a downturn. But now we have the Fed that's going to be easing a lot more than all these other central banks.

And I always like to go back to the euro when really measuring the health of the dollar. I mean, you cannot throw more stuff against the wall and against the euro than what the ECB has done and what the European Region has done. Anemic growth, scolratic welfare system, negative interest rates, massive QE, a central bank that's going to try to get even deeper with negative interest rates like a classic banking system – and the euro still hangs in between this 1.10-1.15 level. It just refuses to break.

And that's partly because they have a current account surplus with us. So there's more euros going in than going out, while we have these exploding deficits.

So the dollar has a problem. And the only reason why it's rallied against certain countries is because those countries have a bigger problem than we do. But I think there are other countries that have less of a problem than we do that the dollar is going to have difficulty rallying against.

I think the net result in trying to figure this out, and getting back to what Erik said earlier, I'm pretty confident that the currency that's going to win out in this environment is going to be gold. And silver is going to go up with it.

So instead of trying to figure out where is the dollar going to rally against, I'm pretty confident that that and all of these other fiat currencies are going to fall relative to the price of gold and silver over the next couple of years.

Danielle: Amen to that, Peter.

Patrick: Erik, do you have anything that you want to put in on the dollar?

Erik: Me have something say on the dollar, Patrick? You know better than to ask.

I think it is incredibly complex and intricate and hard to gauge in the short term.

In the long term though, it's much easier to understand where we're ultimately headed. The US dollar has been the world's global reserve currency since 1944. That creates a tremendous artificial demand for dollars as well as for dollar-denominated sovereign bonds.

And that demand had a tremendous amount to do with the strength of the dollar. For all the negative things that you might say about the US government or the US dollar or the US economy or what have you, it's still the safety trade for most international investors. It is still the world's global reserve currency.

And I don't think a lot of analysts really appreciate as much as they should is that global reserve currency is not a binary switch that's either on or off. The transition from the pound sterling to the dollar didn't just happen at the flip of a switch at Bretton Woods. It really was a transition that occurred with both currencies being parallel global reserve currencies for about 20 years before it eventually became the dollar by treaty at Bretton Woods.

Robert Triffin pointed out way back in the 1950s that no reserve currency can last forever. I don't know when it ends, but someday the US dollar's hegemony over the rest of the global monetary system has to – not change overnight, but it has to fade out.

And when it does, that diminished demand that we're so used to enjoying, the exorbitant privilege that we have of being able to monetize deficit spending because of all of the artificial demand for US-dollar-denominated sovereign bonds.

All of that is going to go away. It doesn't go away overnight. It's a slow fade. If you look at what happened to the pound sterling after Bretton Woods, it was a slow fade. But it was a really, really deep loss of value.

So it's all coming. And I think Luke Gromen has the end game exactly right. I think Luke might be a little bit early with how it happens.

I agree with Peter that gold is going to be the really clear benefactor because, as Danielle says, we're going to be in a race to the bottom competitive devaluation. Which means dollar relative to other currencies is just a question of who happens to be leading in the race right at this moment. But everybody is racing for the bottom.

Gold will be the ultimate benefactor and that's the reason that you've got to own gold in the next decade.

But as far as what happens in the short term, we have right now a global US dollar liquidity squeeze. It's a really serious issue. And it could add to strengthening the dollar dramatically from here. So maybe that's that squeeze into the blow-off top.

But I think Brent Johnson's arguments that we could get to a new all-time high in the dollar index before this is eventually over and the dollar follows the pound sterling's path into oblivion, it's not something that happens over quarters. It's something that happens over decades.

And exactly when it's going to start and where you want to be positioned, the only thing that's really clear to me is, in the next decade especially, you've got to own gold.

Danielle: Well I think the flip side of what you're saying – and I happen to agree with you, Erik – is that people who think that inflation cometh – and I think we're all pretty much in agreement that if some of these MMT type of policies get implemented, then we are going to get inflation.

But I think the stop along the way is going to be a 10-year bond yield that's lower than anybody could have envisioned and lower than even the lows of this cycle. And I don't think people – you know, some of the sell-side banks are starting to come around to the fact that we could certainly break 1.65, hit 1.50. But I'm saying there is the possibility that we actually break the 1.35 level.

And I'm not trying to be hyperbolic. There is just only so much limited supply of this when the world is rushing in all at the same time, because of a very mechanistic dynamic that is going on in the background while we're on our way (just the same as any other horse in a glue factory) to the slaughter.

Erik: Danielle, how low can we go? Because I remember when the German bund, the 3-month paper went negative yield.

One of the first comments that people made was, well, one thing that would be absolutely impossible would be to get to the point where, say, the 10-year yield is negative because that's not possible. And it took a good year or two before it happened.

At that point, when that impossibility happened, the next comment was, well, the 30-year, it's completely impossible. Well, guess what. Now it's happened.

So where is the limit for the US dollar? Is there any reason to think that we can't see the entire US Treasury curve negative the way the German bund curve is?

Danielle: Well, again, I think this is the beggar-thy-neighbor type of argument. Somebody on Planet Earth has to have positive-yielding interest rates or your entire financial system is going to collapse under its own weight of negativity.

Somebody has to have an outlet. Somebody has to have some kind of curve in their yield curve or, I think this entire experiment fails.

Peter: I think, as long as the Fed doesn't lower the overnight rate to below zero, we won't see negative rates anywhere on the US curve. I still think that that 1.30-ish 10-year yield that we saw right after Brexit, that is going to hold and that, in light of everything going on, we're not going to go down to those levels in the 10-year.

It's conventional thinking that we're just going to have the same yield curve as what we've seen overseas. I just don't think it's going to happen. I have no question that the Fed is going to cut the short rate back to zero. But I don't think they're going to be able to drag the 10-year down to those levels.

Erik: You prefaced your statements, Peter, by saying if they don't set a policy rate negative. Does that mean that you're predicting that they won't? And if not, why not?

Peter: I'm really confident that we will not see negative interest rates in the US. As I said earlier, I think the Fed will learn that they will blow up the US money market industry and do major damage to this financial system if they go with negative interest rates. And I think that will be smart enough to see the experience of the European Central Bank and the Bank of Japan.

Patrick: I want to go back to gold.

Peter you brought in the idea that you're very bullish gold and silver. I recently saw you put up a chart that overlaid gold against the global aggregate amount of negative-yielding debt. And you certainly are positioning bullish.

But, in your view, this breakout that occurred on gold, what was the initial catalyst here? And do you really believe that this is definitely the start of the new bull market? Or is there still room for this to be a false start?

Peter: For full disclosure and perspective, I've been bullish since 2000, which means that I've had a 12-year run and had 7 years of bear market. So I've been on both sides and I've been following it closely.

And during the seven years, the gold market has teased us into thinking, okay, this is the beginning of that's bull again. This is the beginning. And then it would rally. And then it would fail. It would rally. It would fail. Rally. Fail.

And when I did the last Real Vision, it felt like, well, this is something that is more real. And that this is not going to fail. Because I think that we've sort of turned the needle on what the Fed was going to do.

And all of a sudden you had gold trading, well, even with rallies on the dollar. And then you had this break out in negative-yielding interest rates where we know it's now about $15 trillion, which is about 1/4 of all sovereign and corporate bonds.

So here you have a bond which used to be an asset. Now it's technically a liability because it belongs to the owner of it. And gold is now a positive-yielding security compared to these negative-yielding bonds.

And then you throw in the technical aspect of getting about this $1,350-1,375 and all of a sudden it came together.

To me, the base case on gold was the Fed raises interest rates, quantitative tightening, the US economy is doing better, the Fed is far and away tighter and moving along on their tightening schedule compared to every other central bank. The dollar is going to rip higher.

And then all the sudden gold stopped going down when the dollar rallied. And then it moved against the dollar index. The dollar sort of stopped rallying.

Coming to 2013, QE infinity. And for the gold, this is going to be the blow-off. You know, there's a time to own it, there's a time not to own it. I can't wait to sell my gold. I just don't think it's yet.

So, going to 2013, QE infinity, this is going to be the blow-off. Gold's going to go to $2,500-3,000. Printing money – ECB's printing, BOJ's printing. And all of a sudden gold collapsed.

It's because there was faith in the Fed. There was faith that the QE was really just to keep the cycle going and that it was going to work. And we weren't worried, we weren't talking recession in late 2012, 2013. It was just growth was sort of mediocre and QE was meant to sort of kick-start it.

Well now we're entering into another easing cycle. Obviously, it's not QE, it's rate cuts instead. But this is actually in response to what is now a growing global slowdown. So the circumstances were different.

And this easing will continue, I believe. And does it get to QE? Yes or no, I don't know. But it's going to be an easing cycle that's going to lift gold. But most importantly, gold is rallying against all currencies right now.

And also, lastly, you have the fall in real rates. And gold is very correlated not to just the negative-yielding situation but it's very correlated to falling real rates. Which, obviously, they're tied together. But that's been a bull case for gold also.

So I do think that December 2015 the bull market began, which, ironically, was just at the beginning of a rate-hiking cycle. Counterintuitive to a lot of people that were bearish on gold. And now we are about 40% higher.

And if I'm right, if it is a bull market that started then, and is now getting another wind behind it, then typically the new bull market picks up the highs of the previous bull market. And I do expect that over the next year or two, and then some.

Patrick: Danielle, how about your views on gold?

Daniele: For the rest of my career I think I'll have post-traumatic stress syndrome from being a bureaucrat inside the Fed for almost a decade. I don't think that's ever going away. And that means that you never forget how correlations feel when they align. And you never get over that shock factor.

I'm no gold bug and people know that I'm no gold bug. But I look at it as being the ultimate hiding place, where you want to be when the confidence bubble, as Peter says, bursts. When we finally figure out that the omnipotence of central bankers is an illusion, I think that there is exactly one place that's going to shield the rest of your portfolio from correlations aligning to 1 in an absolute sense, and that is gold.

And that is why I have taken Peter's guidance and in the last year personally gotten in myself. I don't mind being early. But I certainly do mind being wrong and unprepared. And I think that is how investors should approach gold, regardless of their feel for whether or not it could ever displace a fiat currency.

Patrick: Erik, you have anything else to add?

Erik: Patrick, I've owned gold since 2007 and have a core position in it. And I have long said that in the end game gold is going to be not just something that you want but the asset that you have to have, for all the reasons that Danielle just described. It's the one safe hiding place left. So I think it's incredibly important.

Now, I've also on a speculative basis. I was short gold from 2011 to probably 2016 or 2017. I ended up covering my shorts at $1,180 the first time that we got to $1,180.

And since then I have said I'm holding my core position, but as far as speculative, leveraged money in gold, I was holding off before this breakout because I thought that – there's a really strong argument for US dollar breakout and I still think that argument exists.

Now, once it happens, President Trump may go to extraordinary measures to arrest it. It seems like he's willing to ignore all of his advisors and make policy decisions unilaterally in some cases. And that would be the biggest risk to that view.

I still think the US dollar breakout to 1.04 at least and perhaps higher should create some kind of headwind for gold. But in the face of this re

cent breakout, which was a very, very critical level, somewhere between $1,350 and $1,377 (depending on how you measure the technicals). That cannot be ignored. So what I would hope for at this point is, if we see a technical correction back down to that $1,350 to $1,377 level, I would be a speculative buyer there in addition to my core position.

Now, of course, I had my chance when gold was recently $1,190 or whatever it got down to a few months ago. At that point, I thought the US dollar was going to win. I was wrong. I'm happy to admit that I'm wrong.

At this point, I'm no longer looking to fade gold. I'm looking for where is the buy-on dip opportunity. I'm not going to chase it up here though. I think we've got to have some kind of technical correction.

Certainly, if somebody doesn't own any gold maybe buying some here makes sense just so you don't get completely left behind. But if you're looking at speculative interest in addition to a core holding, or particularly if you're going to use leverage in that speculative interest beyond a core holding, then I think there's probably going to be a better opportunity to buy at a lower level still coming in a technical correction.

Patrick: Finally, I want to move on to the ECB and I want to talk about Europe. We're at a stage where we're probably seeing some of the deepest negative interest rates we've ever seen in Europe. A

At the same time Draghi is ending his term and he's going to pass the baton over to Christine Lagarde. I really wanted to get your impressions as to what this means for Europe and how you think this all plays out. So why don't we start with you, Danielle?

Danielle: Well, I think that putting Christine Lagarde in this position – I mean, there is no worse position in the world after Janet Yellen's that you could inherit (well maybe Kuroda is in the running) that you could inherit aside from Mario Draghi's.

I'm sure that he has literally got a countdown clock, or at least Mrs. Draghi does, who apparently hates Frankfurt and is ready to get back to Rome, thank you. But I'm sure he's got a countdown clock to Halloween trick or treating, celebrating the fact that he is out of the ECB. Even though he's going to have to lower interest rates further into negative territory before he even gets to leave, so he doesn't get to save face.

But why is Christine Lagarde being brought into the European Central Bank? And why from the International Monetary Fund?

I don't think you can speak of the two separately. The IMF knows that the global economy is a ticking time bomb and that all of the money printing that was done after the Financial Crisis is ending up being a gigantic band aide.

Securing adequate funding for the IMF, for what is to come, is absolutely front and center for making sure that the euro experiment does not fail under its own weight. And don't get me wrong, the IMF has asked the United States to whip out the check book and, boy, I'm sure that there is a nice warm reception for that one in the White House.

But, barring that, given the cesspool known as Italy that appears to be sinking into recession, given the fact that Germany seems to be sinking into recession – so you're talking about the two opposite ends of the fiscal spectrum there – what could the solution possibly be outside of bringing in a maverick, bringing in a big thinker, and bringing in somebody who can launch a eurobond to thereby top off what the IMF needs in terms of its funding, which is probably upwards of $500 billion or more at this point.

Patrick: Peter, how about you? What's your take on what's happening in Europe and how this will play out?

Peter: Well, I think that's what Lagarde is going to go for, focus more on the fiscal side. But she's still left holding the bag of this negative interest rate environment. Negative interest rates is not a sustainable forever policy. It has to end at some point. And, obviously, who knows when?

I am interested because, internally within the ECB, they can't get around how to mitigate the current level of negative interest rates. Now, obviously, mitigating is you just get rid of the negative interest rates, but we know the damage that that would do.

And I'm wondering if when Lagarde takes over, if they can't come to an agreement on how to mitigate negative interest rates that, maybe instead of lowering interest rates further, maybe they just rely more on this LTRO (long-term refinancing operation) as a way to help the banks. Which I think would be a good idea compared to going deeper into negative interest rates.

But can you imagine what the bond market reaction is going to be if the ECB does not change their deposit rate from -40 basis points (or let's just call it -50 or -60), there would be an eruption. And that's just by keeping interest rates where they are.

We can talk big picture about what Lagarde will do, but I think there is an imminent decision that is not as easily made as the markets are thinking it to be if the ECB can't figure out how to mitigate this negative interest rate environment.

Because, again, to what I said earlier in the interview, the banks are bleeding. And you can just see it in their stocks. Imagine the ECB presiding over the failure in banks, not because they have bad loans that they can't service, but because of the ECB themselves. Their own regulator has destroyed their profitability and they have no margin to cover their cost structure.

So Lagarde has been on board with everything that the ECB has done up to this point, if you just watch her public comments. But from here on out it gets very difficult to pull off what they want to pull off.

People don't understand that at the peak of QE, the ECB was buying seven times net issuance out of the European bond market on the sovereign side. The Fed was never really more than

25%. So you can't replicate that because, even if they enlarge the capital key from, call it, 1/3 to 50%, there's still not enough German bonds out there for you to even get there.

So we're about to experience the end of the road in terms of ECB easing. Just as we reached the end of the road with respect to the BOJ easing. And I think she's going to have a big problem on her hands in presiding over, at some point, some revolt and some unwind that to me is inevitably going to happen during her tenure.

One last thing. Let's just say she's successful on the fiscal side and she generates quicker growth and higher inflation, well then she blows up the European bond market.

Danielle: Peter is absolutely right. I would add to this, however, that she's also got Brexit to contend with. So she is stepping into some serious conflicts here. And the Germans appear to be trying to stand their ground when it comes to offering up big fiscal relief.

But just listen to what Peter has described about the European banking system and what imposing deeper negative interest rates can do to a bank like Deutsche Bank, even if there is tiering as has been suggested.

So I do not envy Christine Lagarde on any level.

Patrick: Now, Erik, you have some opinions on Christine as well, but particularly in terms of her views on digital currency.

Erik: Well, as some of our listeners know, I wrote a book last year, Patrick, called Beyond Blockchain: The Death of the Dollar and the Future of Digital Currency. And the essential thrust of the book is my prediction that the ultimate resolution to Triffin's dilemma will be the replacement of the US dollar as the world's global reserve currency with a digital currency that is government-issued. Now, that could be the US government or it could be some other government. I don't know.

But the thing that I think most of the crypto-world is completely missing, they think about digital currency in the sense of these cryptocurrencies which were invented by libertarian, borderline anarchists with the goal of frustrating and upsetting governments.

I think it's completely unrealistic to think that bitcoin is going to be the new global reserve currency. I think that's nonsense, in fact. But what I think the crypto community misses is the inventions of distributed ledgers and double-spend-proof digital cash. They benefit government far more than then benefit anyone else.

So the reconfiguration of digital currency, so that it's not crypto currency designed to prevent monetary policy from operating on the currency, which is the way bitcoin is designed, but it is a new generation of central-bank-issued digital currency which delivers just profound advances.

We could advance the international monetary system more in the next 20 years than the central banking establishment has advanced it in the last 500 years, simply by implementing new high-tech monetary policy tools that are possible in a digital currency system. That's what my book is about.

Now, while everybody else in the central banking world – Mark Carney making just astonishingly ignorant public statements about bitcoin – Christine Lagarde was the one voice who stood up (ironically on the very day that my book was released) and said, hey guys, we need to be looking at central-bank-issued digital currencies. And I think it was Christine Lagarde who coined the acronym CBDC – central bank digital currency.

So she's clearly a pioneer. She's one of the very few people in central banking who gets it and sees the picture. And she's taking over what probably is the second most powerful central bank in the world.

Think about what politicians do. They want to have a big win while they're in office. Is she going to be the pioneer that takes the ECB toward a direction of leadership in the digital currency revolution that I've predicted over the next 20 years?

I have idea. But I'll be watching really closely. She certainly is somebody who get it and understand it.

Because my book made a number of predictions that have already come true, but there are also a lot of things like Facebook's Libra that I did not anticipate.

So I have developed a new two-part video series specifically intended for central bankers and other policy makers, explaining to them what they're missing and what they need to be paying attention to as the digital currency revolution really kicks into gear and why Facebook is bad news for humanity that needs to be stopped.

That two-part video series will already have been released by the time this episode airs and you can find it at [macrovoices.com/video-main/macrovoices-videos] or on our [MacroVoices YouTube channel]. So look to those two videos, I think it's close to two hours between the two videos, going really deep on this subject. So I'll leave it there.

But what am I looking at in terms of Christine Lagarde? I'm going to be specifically watching what she does relative to central-bank-issued digital currency in her new role as head of the ECB.

Danielle: To Erik's point, the three countries that rolled out cryptocurrencies, the pioneers if you will, were Venezuela, China, and Russia. So Lagarde is definitely grounded in understanding that cryptocurrencies are going to be some aspect of the future financial system. And the time to look at a Fed cryptocoin I'm sure has come and gone. I'm sure it's being explored internally at the Federal Reserve

But when you consider the three first countries out of the gate, then you have to come to an understanding that electronic currencies will become a matter of national security and be understood in terms of how they're going to interact with other countries and within the countries in which they are deployed.