Jeff Snider: QE Still Isn't Money Printing, and USD Still Isn't Crashing

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Erik: Joining me now is Alhambra Investments Chief Investment Officer, Jeffrey Snider.

For newer listeners who are not familiar with Jeff, he's not only one of our most popular returning guests but he's well known for his slide decks and the quality of his graphs and charts. So you're not going to want to miss the slide deck that accompanies today's interview.

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Jeff, for years now we've had quite a few other guests on MacroVoices tell us that the dollar was doomed. And the things they usually cite are that the government is printing money like it's going out of style, reckless spending. And they're saying eventually this has to lead to debasement of the dollar.

You've been the lone voice saying, hey guys, the dollar is just as broken as you think it is, but it's broken in a very bizarre way where the mechanism for creating more dollars in the international market, the eurodollar system, is not creating dollars the way it's supposed to. And, ironically, that's more likely to lead to dollar appreciation, effectively a short squeeze.

For quite a bit of that time, Jeff, you were kind of proven right. Things were going more in the up direction for the dollar than down.

But I think we've been here before and we have it again. The dollar index is plumbing multi-year lows. It's been trading lower ever since May.

Is this the beginning of that long-forecasted dollar crash which would eventually change your thesis?

Jeff: Well, Erik, there may come a time when the dollar's exchange value is going to fall substantially. And I mean everyone in the world, it seems, is doing everything they can to make it go lower. From politicians to central bankers, there's at least a realization today that a higher

dollar value against most other currencies is bad for everyone on both sides of it.

Now, that's a small bit of progress from when it was settled wisdom how a rising dollar would mean something good. The cleanest dirty shirt or something like that.

And that's never been the case, as you just pointed out. A rising dollar is really a dollar wrecking ball globally.

It's the rest of it which is being so stubbornly difficult: How to we make it stop? How do we make the dollar stop rising?

By every conventional account, what the Federal Reserve is doing should have been more than enough. And some claim that it is, as you just said, that the currency's movements over the last six months or so, that portends the beginning of this long-predicted collapse in the dollar system.

However, if we examine the case for this theory, what we instead find are answers for how the dollar rises as well as why it's not at all likely we're seeing anything right now that represents a categorical change in its underlying condition, the underlying monetary fundamentals.

Erik: Okay, hang on Jeff. Let's be specific about that. And you say underlying monetary fundamentals.

What exactly fundamentals are we talking about? This usually begins with conjecture about money printing leading to substantial devaluation, currency wars, that kind of thing.

Jeff: Yes, and that's pretty much where the dollar crash is supposed to begin. So we'll start our slide presentation on **Slide 3**.

You have an irresponsible central bank seeking to loosen the internal economy up with some inflationary currencies on top of the textbook approach to "beggar thy neighbor" out of some economic rut.

It's the standard stuff. You print a bunch of money, devalue the currency, and you sit back and watch the export sector combine with the domestic inflation and it washes away everyone's problems.

Erik: And if it doesn't work, then that's where it can turn really ugly, right?

I think that's pretty much what a lot of people are saying. Maybe the Fed has crossed a line. Or if they haven't, they're very close to it with all the people talking about MMT and so forth. And maybe trying to be too helpful, if you will, is risking the dollar's status.

Jeff: Yes, I think that's the point. And it's not just the Federal Reserve, either. The federal

government has certainly played up to its presumed role in the dollar crash, too. Unbelievable deficits, insane levels of cash, and on and on. And with the dollar moving lower since around May.

These ingredients all feature prominently in it. Many people are thinking it can't possibly go any other way.

And there's a third element to this, too. One that we hear a lot too. The third part to the fundamental story of a dollar crash. And that's foreign rejection of all of these monetary excesses.

It's going to unleash something like the 1970s Great Inflation when countries around the world start speaking about being on the short end of the money-printing stick. Places like China, a name that comes up time and again.

They aren't going to stand for it any longer, supposedly. They'll figure out a replacement, or they might be already on the cusp of a replacement, and the dollar won't just fall. It will crash down to zero. And then of course the Treasury market will go with it.

Erik: Well, Jeff, I know you well enough to know that you're not buying the crash to zero part at least.

First of all, we've heard both of these things for years. Money printing leading to inflation and the insanity of the federal government leaving the world with too many Treasuries, and China and Russia actively working on some kind of rumored – potentially a digital currency system that might be just around the corner.

Jeff: Yes. So let's take these one at a time.

And It all goes back to money printing. That's where it really starts.

[**Slide 4**] Central banks, they adopt QE or some other form of large-scale asset purchase program, which leads to a radical increase in the size of the central bank's balance sheet.

And by the necessity of central bank balance sheet accounting, it leads to a radical increase in the balance of reserves in the system, the so-called money printing.

And, as you've pointed out, Erik, we've been hearing about this for years. Decades. We're hearing all about it again recently.

[**Slide 5**] For the better part of the last half year, that's all anyone is talking about again. Inflation, money printing, the Federal Reserve doing way too much. And that's just what Jay Powell actually wants. That's how monetary policy actually works, getting people to talk about inflation.

And the reason he wants this is because in reality there hasn't been any money printed whatsoever. The level of bank reserves has increased, sure. But are bank reserves effectively money? That's the question you have to ask and it's the question you're not supposed to ask.

Nor are you supposed to remember how – go back to 2009 and 2010 – we had heard all of these same things before.

[**Slide 6**] Anna Schwartz of *A Monetary History* fame – her and Milton Friedman wrote that famous book in 1963 – famed monetarist – in July 2009 she was arguing against Ben Bernanke's reappointment as Federal Reserve chairman because he crossed a line. Back then, she said the same thing we hear now: The balance sheet had exploded by trillions.

Marty Feldstein, around the same time – another famous economist – said it was surefire inflation from that point forward. And he actually referenced both the Fed and the federal government being irresponsible [**Slide 7**]. both of the first two items on our dollar crash wish list.

There was definitely drunken-sailor levels of spending. Supposedly, Weimar levels of money printing. And those were going to add up to something like 1979 levels of inflation if not something worse.

And then in November of 2010, along comes the second round of quantitative easing in the United States. And somehow, nobody bothered to really think about how, if Ben Bernanke thought he needed to do a second QE, what that must have meant monetarily about the money-printing effectiveness of the first one.

Erik: Instead, most people assumed that, well, if QE1 wasn't enough – and clearly it wasn't – they focused on how QE2 would cross that line, if the second one would prove to be too much.

Jeff: Exactly. And that was really the pattern which got established and survives to this day, as we're just talking about.

Once another QE comes out, everyone forgets about how the last one which was advertised as it came out as the greatest, most awesome money printing ever – how it couldn't have been those things.

If it had been, no repeat would ever have been needed. Rather, our attention gets quite purposefully pulled forward into considering only what the next QE must be.

Back in November of 2010, QE1 had already been forgotten, just as Ben Bernanke wished. Suddenly the inflationary fears of QE2 (but not the inflation itself), those were ignited by what happened in 2010.

There was that famous open letter from a group of very prominent economists. I think it was called the E21, and I've got that on **Slide 8**.

They wrote this letter to Ben Bernanke telling him hey, stop. Don't do the second QE before it was too late. Because, they said, it was going to unleash inflation and wreck the dollar. Even though, again, QE1 hadn't done either of those things because QE1 wasn't really money printing either.

Erik: If I'm remembering my dollar history correctly, Jeff, this is also where the term "currency wars" showed up. It was right in that QE2 timeframe. And suddenly everybody was talking currency wars and competitive devaluation and so forth.

Officials around the world were freaking out over Ben Bernanke going back to his printing press for a second time. And the second time, of course, was bigger than the first time. And that caused, frankly, a lot of big reactions around the world.

Jeff: Yes. Brazil's Finance Minister, Guido Mantega, who, in late September of 2010, he's the one who actually said that Ben Bernanke wasn't just risking a currency war (as you can see on **Slide 9**), that the currency war had already begun – even though QE2 hadn't officially been announced and voted until November.

Remember, it was at Jackson Hole in August of 2010, just a month before Mantega's currency war proclamation, that's when Ben Bernanke had affirmed the Fed's intent to start up a second round of QE.

And, listen, it wasn't just foreigners or even commentators like us talking about this inflation and dollar crash and all that kind of stuff. Policy makers and staff at the Federal Reserve, they believed in this devaluation stuff wholeheartedly.

[**Slide 10**] In November 2010 at the FOMC meeting, when the vote for QE2 was actually held, the committee heard the staff present studies which very strongly suggested that theoretically QE could lead to lower currency values.

And if there had been any benefits from QE from the first one, it had accrued almost entirely through the US export channel. So, very textbook stuff.

Erik: Okay, Jeff. So what you're saying is that in November of 2010 the FOMC was saying when they voted for QE2 that they fully expected that it would lead to a lower dollar. And that it was going to produce the economic benefits that enhance the economy's growth potential to the point where it would become a legitimate recovery?

Jeff: Not just that. As you can see by this quote from Governor Warsh (still on **Slide 10**), they also discussed how the rest of the world should be happy about this.

The Fed was going to push the dollar lower. Not by actual money printing, but instead through how that was supposed to work through inflation expectations. And that would boost US exports to get the US economy going again. And then that would lead the world out of its post-Crisis rut.

[**Slide 11**] They absolutely expected and were absolutely counting on a lower dollar value being the major thrust of global economic recovery.

And those first couple of years in the post-Crisis period were very reminiscent of where we are right now. Everyone – I mean everyone – said inflation and lower dollar is definitely happening. It was a done deal. And, also like now, the dollar was falling at that time against most currencies.

But the dollar was never really tanking nor really at risk of tanking, not even back then, which didn't really fit the dollar-crash narrative or all the things that were supposedly going on with money printing. Nor were there any market indications that we were at risk of some major inflationary breakout.

And then, right when the dollar crash was supposed to really show up, right around early 2011 in the midst of QE2, instead the opposite took place.

[**Slide 12**] The dollar spiked, Treasury yields tanked, inflation expectations all dropped. And these are all the contrary changes which show that, at the very least, there had to have been something huge missing from this dollar crash, bond rout, money printing, and inflationary story.

Erik: Okay, Jeff. But the end of 2010, early 2011, that was a full decade ago. I think the argument today is that central banks like the Fed have so far surpassed what they did back then.

It's the size of the current money printing – size matters – that a lot of people are now saying is going to lead to inflation and the dollar crash. Jay Powell's current QE dwarfs the size of Ben Bernanke's biggest QE.

So I think the argument is these things keep getting bigger. How long can this go on that they just keep getting bigger?

Jeff: Yes, and that's always the excuse, right? I call it the magic number theory. That QE as money printing works like money printing, except it's never enough money printing.

Its proponents always claim it will start working and maybe work too well once the central bank hits upon that exact right magic number, which we are told always has to be much bigger than the last magic number, which in hindsight couldn't have been big enough. It's always bigger, bigger, bigger.

And if you actually think about, you'll already notice how it falsifies the entire QE premise. QE means quantitative easing, which already denotes that the central bank is doing the quantifying and therefore it must already know the right quantity of easing in order to produce the desired inflationary and recovery results.

So if there's any more than a single QE, then straight away you are alerted to the fact that, well, it couldn't have been quantitative, could it? Already something's wrong, something's missing.

And you're right, Erik. If you are a central bank and you've screwed up the number, the size of the large-scale asset purchase program, then merely change the size and give it a second try. Or a third or a fourth or a twenty-fourth, as in Japan. The magic number has to be in there somewhere, right?

Here's the thing though. Japan already did this massive upsizing. They did this massive upsizing.

[**Slide 13**] Many years ago, Japanese monetary officials quite purposefully designed what they called QQE to look and be as huge and irresponsible as humanly possible. The numbers were going to be so damned big it wouldn't leave a single doubt. That was the whole point of QQE.

So, in technical terms, they said this was a credible promise to be irresponsible with money printing. The Bank of Japan would print so much money, so many Japanese yen bank reserves, and create them out of thin air, they wouldn't leave a single – this was guaranteed to be inflationary because it was so big.

Erik: Okay. I remember that was April of 2013. It was one of the big arrows of what was at the time called Abenomics.

The Japanese said this was the new way of doing things, and that the central bank being – I don't know if they used the word irresponsible – but if the central banks just went and printed and printed and printed on top of reducing the yen, there was no way that it could do anything other than snap Japan's economy out of what they said was its deflationary mindset.

Jeff: Yes. QQE was the biggest of the big. It was so big it was the QE to end all QEs. It was so huge there was no possible way that they wouldn't figure out the magic number because they were guaranteed to go way beyond that level.

And, once again, in the first few months it looked like it was happening. [**Slide 14**] Inflation rates in Japan initially shot upward. They were boosted in early 2014 by the effects of the VAT tax hike. And so Haruhiko Kuroda's gambit seemed right on course, right off the bat.

But then, quite predictably, it very quickly fell apart. By October 2014, just a year and a half into QQE, they were suddenly making adjustments to it. Apparently it wasn't big enough; it had to be bigger.

What was supposed to have been the most irresponsible money printing ever conceived apparently, again, needed to be even more irresponsible.

And the adjustments to QQE just never stopped because, as you can see on these slides, inflation didn't do what they said it would. Rather than surge into some new growth paradigm with positive inflation above the central bank target, prices began to fall right back into deflation.

[**Slide 15**] So QQE was boosted in early 2016 with now negative interest rates, NERT policy. And then in September 2016 the Bank of Japan said they were now going to let inflation go above and stay above their target for an extended period of time, what they called overshooting, as you can see on **Slide 16**.

Erik: Okay. Now that sounds really familiar.

Didn't the Federal Reserve just come out recently with average inflation targeting which also states that the FOMC is going to let inflation go above and stay above the Fed's target for as long as it takes to balance out this period of low inflation?

Jeff: We'll get to that in a minute. But you're absolutely right, Erik. That's a major point I'm trying to make here. Everything that the Fed has done, is doing, or will ever try, was first tried out in Japan. I mean everything.

You can see here very plainly how this overshooting policy, combined with ungodly huge QQE money printing in Japan, it accomplished next to nothing.

[**Slide 17**] Like before, consumer prices accelerated modestly in 2017, which fooled the Bank of Japan and quite a few other people into thinking in early 2018 that it was in reach of its economic goals of inflation and recovery.

And that's the other excuse that's always made for QEs: If it's not the right magic number or the right size, then it must not have been given a long enough period of time to work.

Again, this QE stuff, this money printing stuff supposedly works if you give it enough time and you figure out the right quantity, when the name itself conveys those things have been figured out beforehand. It's awful fickle in a way that sounds nothing like straightforward money printing.

Erik: Instead, just like before, despite QQE plus the negative interest rates plus this policy of overshooting the inflation target, it didn't happen, did it?

Jeff: No. And it wasn't even close. By the end of 2018 [**Slide 18**], consumer price gains were again decelerating all over, CPI rates were falling, and they kept dropping all the way through

2019.

And the overshooting policy that had referenced the core CPI, which is the CPI in Japan, not including fresh food prices.

The Bank of Japan said in 2016, when they revealed this overshooting policy, that it expected this core CPI rate would not only rise above 2%, they would let it remain above 2% in a stable manner. So go above 2% and then stay above 2% for a long time.

In reality, it only ever got at most halfway. As you can see on **Slide 19**, the core CPI reached just 1%. And that was only in three months out of 50 since the policy was unveiled.

Erik: Three out of 50, and those three were only halfway to the target?

Jeff: Yes. Just three out of 50 at just 1%. So the other 47 months were less than 1%. And often substantially less than 1%. So forget 2%. Forget anything above 2%.

And it's just laughable, the idea of staying above 2% for any length of time even as at the same time the Bank of Japan's balance sheet shoots up toward a quadrillion. They surpassed half a quadrillion and they're closing in on three quarters of a quadrillion now.

More importantly though, this year the Bank of Japan, like other central banks around the world, they have re-energized QQE. [**Slide 20**] The central bank's balance sheet is again expanding. And expanding now at a rate that exceeded what it was doing back in the early QQE days.

The alleged money printing binge is now back, and back to another higher magic number. Or at least what officials hope this time – this time – that will be the magic number. Again, most people are claiming, well, this time they can't possibly miss because there is just so much of it going on.

And, quite predictably, once again, inflation has become outright deflation. Not only that. In terms of the core CPI – again, the core CPI is what the Bank of Japan is using as their measurement tool – it's become entrenched deflation where, for this core CPI, in the month of October 2020 at least, it turned out to be the worst level of broad consumer price retreat in almost a decade, going back to 2011.

So this policy of overshooting, the greatly expanded level of QQE money printing, negative interest rates, all of that huge monetary stuff the financial media always describe as ultra-loose and ultra-accommodative, and Japan is right back in deflation anyway.

Erik: Jeff, without at least a small uptick in inflation rates, the yen probably isn't going anywhere, either. That's the other part of this, right? The currency debasement expectation. Huge amounts of reckless money printing is supposed to, in this case, wreck the yen.

Jeff: Yes. Absolutely. And it never happened, either. The yen had fallen when Abenomics was announced back in 2012. But, by and large, while QQE and all these other policies have been ongoing, the yen is on a decidedly upward trajectory as you can see on **Slide 21**.

And it is right around the same exchange value today against the dollar as it had been when QQE was starting up back in April 2013. And it's materially higher than it was back in 2008 before this searching for the magic number of QEs restarted in early 2009.

So no inflation. No debasement. It didn't matter one bit the scale, the size of the money printing, or how long these things were strung out. To the point you really start to question what really is a simple premise.

[**Slide 22**] If QE equals money printing as everyone says, and money printing always leads to inflation as history has conclusively established, then how can QE not equal inflation? Either history is wrong about that, which is not likely at all, or QE just isn't money printing. Those are the only two options.

And it's not like we don't have a sufficient sample size here. It's been empirically and experimentally established all over the world using all sorts of different parameters.

Like we were just saying, in the US, monetary policy has closely followed the Japanese example as you can see on **Slide 23**.

From borrowing QE initially, now in 2020 the Fed program is pretty much the same thing as QQE, which is massive QE, buying different asset classes and things like that. And also implementing this overshooting policy, which in May 2018 the Fed adopted and called a symmetrical inflation target which was merely updated this year in August of 2020 by calling it average inflation targeting.

It doesn't matter. In all of these cases it works out to exactly the same. There is never any inflation.

Erik: So that's true in more places than Japan. We hear about this excessive liquidity and money printing, but no out-of-control consumer prices anywhere. In fact, inflation indices at least, whatever you make of them – some people think that they are not very accurate – they indicate lower inflation today than in the pre-Crisis period.

Jeff: Yes. And it's uniformly that way. Everywhere. The US case is actually the best case in that inflation hasn't been as negative or stayed as low as it has in places like Japan.

But even so, where's the money printing? It's just not happening. It's not coming out of the consumer prices, as you can see on **Slide 24**.

And as you said, Erik, on the contrary, there was far more inflation and on a sustained basis before 2008, before the eurodollar system broke down, when the Fed practically did nothing.

All the Fed did in the pre-Crisis era was move the federal funds rate around here and there a quarter point a little bit at a time and then claiming credit for what they said was a "Great Moderation."

And then after 2008, the Fed expanded its balance sheet massively: several QEs, trillions in bank reserves. And inflation and economic growth, where those have been concerned, we don't get much of either of those things.

So the more the Fed does, the less it seems it accomplishes. So we're missing something here. And that's really the important point about inflation – it's not really about consumer prices.

So even in 2020, despite what's supposed to have been a biblical level of flood of digital money printing, there isn't even the slightest hint of inflation pressures.

Instead, there are quite a few growing indications of not just disinflationary pressures but, as we saw in October's CPI and PCE deflator numbers here in the United States, the balance of probabilities are far more tilted toward deflation, like Japan, right now.

Erik: So we might not have inflation today, but could we see higher inflation down the road after all of this record government and central bank activity?

Jeff: Yes. And it's not just right now, right? The current month or today.

[**Slide 25**] If we look at forward-looking markets such as TIPS and inflation break-evens or long-run inflation expectations, same thing: zero, zilch, nada, nothing.

Inflation expectations right now on the bond market remain on the side of historical lows far more than they are trending even toward average inflation rates.

So the bond market and inflation expectations, as well as nominal yields and the Treasury market and money curves and things like that, they have shown that, especially since going back to early 2013, there just isn't anything inflationary or even increasing growth to expect from these QEs and QQEs.

Erik: That's quite the coincidence here. You've got circled US inflation expectations peaking in February of 2013, which is right around when QQE was started up in Japan. At the same time, the Federal Reserve, as your chart shows, was full throttle on QE3, or what you say was QE4. Or QE3 and QE4? I'm not sure which.

Jeff: Yes. Most people say there were only 3 QEs up to that point, when there actually were four before 2014. And you're right, Erik, the market at that time had sniffed out those last two,

QE3 and QE4 in the US, how they just weren't going to lead to any rise in inflation.

And it never happened. It's still not happening. So the bond market unequivocally tells you this isn't money printing. It's not inflationary currency.

And you can go over to Europe, too, [**Slide 26**] and you find exactly the same things there. There is no correlation whatsoever between what the media calls money printing, these huge increases in bank reserves that everyone can see, and levels of consumer price increases.

In fact, right now, just like in Japan, in Europe the ECB has gone absolutely crazy, absolutely nuts in this year with a huge amount of QE. And, also like Japan, inflation rates are now deflation rates in Europe.

So even the core inflation rate in Europe, which remains just barely on the plus side of zero, even though it's still positive for the last two months running, these are the lowest core inflation rates on record in Europe.

So it's not just QQE isn't money printing. It can't be money printing. Again, if money printing leads to inflation, then QE or QQE (whatever you want to call it) isn't money printing.

Erik: Okay, so let's net this down. Going back to your list of factors for a potential dollar crash, you're basically – all of this is just to say you are unequivocally crossing the first one off: money printing.

Jeff: Yes. So [**Slide 27**] there is no magic number of bank reserves or central bank balance sheet size. There is no "long enough" period of time for QE. It's 100% empirically established there is no relationship between the central bank balance sheet expansion, an increase in bank reserves, and in consumer price increases or acceleration. It just doesn't exist.

We've got 12 years of that in the West. We've got nearing 20 years of this stuff, this money printing bank reserves in Japan. We've got a range of all sorts of geographies, all kinds of variations in the programs, different lengths, different asset classes being targeted, variations in monthly rates, etc. You name it. QE has been tested to death.

There really is no doubt about it – except that everyone still says it is money printing. Except that's not really a basis for realistic analysis.

And so you have to ask why? What's missing? The only conclusion is that it can't be money printing at all.

Erik: Okay, Jeff. But the argument you're making here is that the Federal Reserve's quantitative easing isn't really the same thing as money printing the way most people think it is. Fair enough.

But, look, the federal government still could crash the dollar. That's the next factor on your list, isn't it? Deficit spending so big that there is just not enough buyers for all those Treasury securities that they have to issue in order to pay for the deficit spending. That could lead to a loss of confidence.

And you know the rest of the story. It's a self-reinforcing vicious cycle that leads to a collapse of the currency.

Jeff: Yes. And this is another one we've heard several times. Like the QE/inflation criticisms of the early post-Crisis period, there was – as I pointed out with Martin Feldstein's article from April 2009 – there was a wave of warnings back then about government borrowing being too much in the early Obama administration.

And it was the same story then as now. The scale of deficits in 2009 and 2010, they were nothing like we had ever seen before, not since World War II. And ultimately that didn't really matter either.

Same thing in Japan going back to the 1990s. In Japan, the fiscal recklessness, that was always by design. It was never an accident.

So that, along with zero interest rates and the QEs again, in Japan no inflation, no destruction of the yen, no legitimate recovery, none of those things either.

And now, of course this year we've got even bigger deficits and borrowing in the United States. Which again, as you pointed out, leads many people to assume there is some line or threshold or some magic number that we'll cross which will trigger the market to begin first rejecting Treasury paper then ultimately the dollar, as I'm showing on **Slides 28, 29, and 30**.

Erik: Well that's not new either, Jeff. Even in recent times, we heard pretty consistently – ever since the tax reform took place in December of 2017 we were hearing how that was going to lead to a big increase in the fiscal deficit. And it did. That most certainly had that effect.

But we were also told that was going to create the problem of too many Treasuries. And that would presumably – if there's too many Treasuries and there's not enough demand, interest rates are going to start to run away to the upside.

But it never happened. They never really rose all that much. And today, obviously, there are still lower – substantially lower – just like the dollar is substantially higher.

Jeff: Yes, Erik, the too many Treasuries argument never made too much sense to me. It was demonstrably false, actually. Only starting with the correlation to the rising dollar – as I'm showing you on these **Slides 28, 29, and 30** – demand for US Treasury paper, a rising dollar indicating too few dollars globally rather than too many Treasuries. That was a major point.

Most of this argument centered on how the banking system was being stuck supposedly with Treasury securities that we were told it didn't want or couldn't adequately absorb. And that was just false. It's established here by the market prices over a very long period of time.

At no time were the results of a single Treasury auction indicative of anything other than over-demand (for lack of a better term).

Even if foreign buyers weren't bidding as much as they had been, which was true – though for reasons of a dollar shortage rather than any kind of distaste for dollars or government deficits – primary dealers were consistently more than willing to buy up each and every bond, note, and bill anyway.

When a global dollar shortage shows up, as we saw in early 2018 coincident to the deficit rising after tax reform, that's why inflation never shows up and why QEs are worthless and ineffective. Because it's really good business to be in the US Treasury auction business even if foreigners – the indirect bids – disappear from the auctions.

Dealers, primary dealers, these bank dealers know there is tremendous value to that auctioned-off Treasury paper, value which is only enhanced by a global dollar shortage.

So dealers bid for it, up to position limits in some of the non-competitive bids, for their own house accounts in the sense of their bank book, which is holding the securities until maturity, therefore betting on the price going higher. Or their bid for them at auctions for what their brokerage network is telling them they can sell off easily to the public at even higher prices. Or for reasons that have more to do with survival in terms of repo collateral.

And that means stockpiling the best on-the-run securities in their house accounts for their own purposes, or intending to profit off the survival risks of others who they believe are going to find themselves short of on-the-run collateral in the near future.

Either way, that's what Treasury auctions have been saying this whole time over the last couple of years, including all of 2020 so far. Not that there's too many Treasuries but there's not enough.

Even if dealers were taking on more securities than they had ever wanted to, they knew without a doubt they could easily sell them to the public that demands them at almost any price. There was never any danger of there being too many Treasuries.

Erik: Well, and that's also been true of recent auctions. Not just before 2020, but also Treasury auctions taking place more recently?

Jeff: Yes. Even as yields have increased modestly since August – very modestly – the auction fundamentals remain as solid as ever as dealers buy up whatever is being supplied. And the amount being supplied is far greater than anything we've seen since World War II, so obviously

surpassing what was done in 2009 and 2010, which triggered all of those fears back then.

And that part is absolutely true. The federal government is borrowing in excess of anything we've ever seen before.

Erik: Some people claim that's just QE. The Fed buying Treasuries to rescue the market. Obviously, if the Fed is buying Treasuries, then there's going to be somebody to buy them because the Fed is artificially there creating that artificial demand or to monetize the debt.

Doesn't that account for why we're not seeing this lack of a bid in Treasuries?

Jeff: Well, yes. But the auctions still work out the same way as they did before. The price is the price, not a single indication of lack of demand. That has nothing to do with the Fed. Especially since the Fed quite intentionally stayed out of the bill market auctions, which is where most of that huge increase in borrowing was done – at auction.

The private banking system easily absorbed those several trillion in T-bills while the Fed was focused, for reasons it didn't really understand, in the stale, off-the-run bonds and notes.

Plus, there's no way dealers are going to depend on the Fed and QE to bail them out of a situation they don't want to be in. That's not what keeps them coming back at auction. And it's certainly not what's driving private, non-dealer demand for Treasuries.

As I said, all the data shows conclusively there's no inflation risk from QE and the global dollar shortages that are Treasury price-positive.

So if QE isn't money printing, what would that mean so far as the dollar shortage goes? Or the risk of the dollar crash? Or the end of the so-called Treasury bond bull market?

[**Slide 31**] Every time we hear about these things, how inflation is going to kill the dollar and end the bond bull, the dollar is somehow higher and interest rates somehow lower than the last time we heard all these same things.

Whether it's auction data, market data, inflation data, the banking system is consistently telling you that these things are not happening and they're not expected to happen. That there is something else other than QE because bank reserves aren't money printing. There's other things going on that you don't see that you have to pay attention to.

Erik: Okay, Jeff. But if US dollar inflation, or I guess more specifically the devaluation of the US dollar, isn't something that we need to be worried about, then why do we keep hearing about the dollar being replaced as the reserve currency?

I mean, you've got all kinds of foreign leaders making outspoken statements that they need to find an alternative to the US dollar in order to replace its role at the center of the global

monetary system.

That is true too, isn't it?

And Maybe QE isn't money printing. And maybe it doesn't matter right now, today, that the US government is drunk on spending. But foreigners are saying they are not happy about the fact that the US dollar is still the global reserve currency.

What's their reasoning? If it's not currency wars, if that's not it, why do we have foreign governments saying they're looking for an alternative?

And a lot of governments are saying they're looking for an alternative. You've got China actually working hard to introduce a digital currency alternative. They haven't quite come out and said they want to replace the dollar as the global reserve currency, but I'm convinced that that is their agenda.

Jeff: [**Slide 32**] Yes. I'm not. In fact, the reason that everybody is not happy with the dollar is because there is a dollar shortage, not devaluation. That's a form of malfunction which harms the global economy, just not in an inflationary way.

These governments around the world can look at their own economy and say things are not right here and know the dollar is the big problem for it.

It's actually worse than that. The entire global economy gets harmed by these dollar shortages. The US is part of it, too. But it's way worse overseas, especially since 2011. And that's the period when the dollar has risen the most.

If you actually listen to what foreign officials are saying, at least what I think they're saying, that's what they are really talking about. The dollar system doesn't work. And even if they don't specifically know exactly why or what the problem actually is, they can tell it has nothing to do with currency wars because there aren't any currency wars because there isn't any devaluation.

There is something wrong with the dollar. We don't know what it is. But it's the dollar system that doesn't work.

But what we know is that this dollar shortage is the only thing that comes and goes. It gets worse, the dollar rises, the global economy suffers. And then it gets a little bit less worse, there is a reflationary period, the dollar falls a little bit as it's doing now – but that's entirely different from a dollar crash, especially at these times when the global economy seems like it's getting better.

But we can tell – even foreign politicians and central bankers can tell – there is something not right with the dollar system.

The dollar can go lower against a broad range of currencies, but it never seems to crash. Like right now. The global economy looks like it is rebounding or picking up, but even foreign officials understand it's not the same thing as recovery because it never accelerates into full inflation and full recovery.

This dollar shortage never stops, which is the primary reason why we keep hearing about the dollar system being replaced.

And as you go to **Slide 33**, I use one proxy for the global dollar system and what must be going on in it using Treasury International Capital data of the banking system. It is the symptoms of this ongoing shortage that draws the ire of foreign officials who can make out at least this obvious correlation: When the dollar rises or it goes higher or stays higher, it's just bad for everyone.

Erik: Okay. Now, it sounds to me like what we're really coming back to here, Jeff, is a topic that you went to incredible detail in in a series we did with you a few years ago called Eurodollar University. Listeners, it's way too much to get into right now because it's hours of content, but it's still free of charge at macrovoices.com/edu.

What that series is about, Jeff, is a part of the monetary system which we know is there. Milton Friedman and a lot of other famous people have told us it was there. They've been telling us that for decades, but it's kind of hard to see. And that's the part that's causing the problems.

I know you've used the term "shadow money" before. What are we talking about here?

Jeff: Yes, it's almost impossible to see. There is no direct observations of what's going on in the eurodollar system. It's this enormous, offshore dollar money system and it performs the roles of the global reserve currency system.

And nobody monitors it. We have really no idea what's going on there.

The only way we can tell what's going on is because we look at markets and try to piece together a coherent picture of what the markets, the banking system (which actually operates the eurodollar system), what they are telling us must be going on in these shadow places that we can't directly observe.

And that's why it's been so very confusing. Because the public sees the central bank create trillions in bank reserves, and everyone's told those bank reserves are base money, therefore this must be money printing.

But no one knows about the shadow system where bank reserves don't really matter. And you can't see the deflationary money tightness, which is why we never get inflation nor legitimate levels of economic growth and recovery.

So you see the one and think it has to be inflationary, but you never see what actually matters except if you're paying close attention to the bond markets and some other signals. And that's what produces this constant deflationary drag that pushes the dollar higher and higher over time.

And that's also what foreign officials have realized, since especially 2011, that's what they actually need to be concerned about.

Erik: Jeff, before we go on, I just want to mention for any newer listeners that we have what we're talking about here. First, a lot of people think that money is created by the government. Really, that's not true. Money is created by the private banking system. It gets lent into existence, and that's a very well-known fact. Nobody disputes it.

What's not nearly as well known is that when all of the monitors and controls that show you the money creation that's occurring in the private banking system, they're only tracking the operations that are occurring in the United States where they have to report what they're doing.

Jeff's entire argument for the eurodollar system centers on the idea that international banks are creating US dollar money supply. They are literally bringing new US dollars into existence. And that system is one that very few people, even in professional finance, fully understand.

I strongly encourage anyone who is interested in that to check out our free Eurodollar University at macrovoices.com/edu. (Sorry for that little PSA, Jeff.)

I think we left off, you were talking about officials. Are we including China and Chinese officials in that category?

Jeff: Yes I am. I think if you listen to what they've been saying for years now, it's that the dollar system just doesn't work for China. Not just China, but for anyone else. That's the rising dollar, dollar shortage problem.

And the real problem is that you can't just flip a switch and replace the dollar by fiat decree – pun intended. It just doesn't work that way.

Again, it's really hard to picture because this is, again, a shadow system. But it's an enormous system. It's made up of interlocking, sophisticated, and dynamic marketplaces which many decades ago – as you just pointed out, Erik, very correctly – it blurred the lines between raw money and credit and debt usage.

So we have this massive infrastructure. It's an unimaginable complex that arose over a period of many decades, which undertook the true roles of a global reserve currency. And it's just not something you can replicate overnight, or even in just a few years.

[**Slides 34, 35, and 36**] I think that's why Yi Gang, who is the current head of the People's Bank of China, he has been very consistently arguing for the IMF's SDRs to be worked into a more prominent global monetary role, including this year.

He's realizing, first of all, it will take years of concerted effort to even get to that point where we might even be able to think about SDRs having a sufficient system behind it in order to take on some of the global reserve chores.

And this is why in late 2020, more than a dozen years after the first global shortage showed up in August of 2007, we're still here talking about QEs, we're still talking about why they'll never be inflationary, why the dollar only goes higher over time, not always in a straight line, and why the global economy can never seem to get its footing.

It's because there isn't any legitimate eurodollar reserve replacement on the horizon.

For one thing, hardly anyone knows what the real reserve currency is. As you just said, Erik, the eurodollar, most people have never even heard that term.

And there's even fewer people – even some who have heard the term eurodollar – about how it actually takes place and how it gets done. This eurodollar system simply sticks around because there is no replacement for it.

So what happens instead is we periodically hear about how this or that is going to challenge the dollar because what's really evident is that there is massive dissatisfaction for it.

Erik: Something like the petroyuan, right? That was supposed to have been a game changer as far as changing the US dollar's status.

Jeff: Yes. And it's kind of funny how when that debuted, the petroyuan, in March of 2018 [**Slide 37**] and within two weeks or so the dollar began its latest leg upward. Whatever the petroyuan was supposed to have meant so far as CNY and China taking a larger role in the global reserve – pricing oil in local currency – it was all quite predictably and easily superseded by the last dollar shortage, which began around the exact same time.

This is the thing which undermines and underlines everything else. Deflation versus inflation. Rising rates versus falling rates. Higher dollar or dollar drifting somewhat lower versus the dollar crash, which never happens and won't so long as nothing in the eurodollar system materially changes.

And that's really the whole point here. Ever since August 9 2007, this dysfunctional eurodollar system has been the only constant.

QEs come and go. They get amped up. There's hysterical shrieks about dollar crashes and the death of the Treasury market. But, just like Japan, so long as the shadow money system remains

this way – and there's absolutely no indication it's changing to something else – this is what rules our dollar crash list.

[**Slide 38**] Number 1, QE isn't money printing because shadow money, of which bank reserves don't help and don't really count, it's the shadow money that counts. It's the shadow money that rules the system.

It's not what you see on a central bank's balance sheet that matters. It's what you don't see that does.

Number 2, while it is absolutely true the federal government has gone absolutely crazy, ridiculously crazy, that's not something to worry about today because global dollar shortage liquidity risks remain paramount over some future reckoning with the credit risks of that ridiculous spending.

So the demand for the safest, most liquid assets can go on and on – and that includes dollars as reserves, as it has for over a dozen years – so long as the deflationary shadow eurodollar system remains as the global reserve basis, the federal government is taking advantage of that deflationary condition.

And so long as there is that deflationary condition to take advantage of, and if all we're given is worthless, useless QEs, one after another, the federal government will continue to be able to take advantage of deflationary conditions.

And the third thing, finally, a global reserve currency just cannot be replaced by decree or by wishing it. It's not a matter of political will, either. It is first and foremost a technical matter that is just way beyond the capabilities of economists and central bankers to apparently comprehend.

That's why they keep repeating QEs.

Monetary scholarship – you have to realize monetary scholarship, actually looking at the monetary system, that dried up half a century ago. Economists and their DSGE models, they pay no attention whatsoever to this stuff.

That's not something you can just get back overnight and become technically proficient in a very short period and condensed space. And even though 2008 was 12 years ago, in the dozen years since then there's only been small, isolated, really half-hearted efforts to try to really figure out what's going on out there.

Changing a reserve currency requires massive effort, years of planning, at the very least some widespread recognition that there is a problem or what that problem actually is. And we aren't anywhere close to any of those things.

And that's why here in 2020, after so many years, after a decade of hearing about how (for example) the Chinese are going to take out the dollar, the eurodollar system remains unchallenged, leaving nothing more than Yi Gang and the PBOC to fruitlessly plead its case about SDRs or something else.

Erik: Okay, Jeff, I have to be honest. I am still having a hard time with parts of this.

Now, first I want to credit you. You've made an extremely coherent, wisely stated argument for why QE as was implemented in Japan, as was introduced to US monetary policy by Ben Bernanke and then expanded upon by Janet Yellen, that's not really money printing that pumps money into the real economy. What that is is the creation of excess bank reserves.

And I think you've made the point very well that people have misunderstood that and assumed it was inflationary when it wasn't. And I agree with you on that.

But, hang on a second here, Jeff. I recently interviewed Stephanie Kelton. Professor Stephanie Kelton is one of the most outspoken proponents in the public policy space of the prescriptions of modern monetary theory.

Now, Stephanie Kelton is not talking about more QE for the purpose of creating more bank reserves. She is talking very openly – and I think she understands very much what she's saying – she's saying, look, we need to essentially monetize government spending. We need to print more money for the purpose of dramatically increasing social support programs, infrastructure spending, doing more things to pump more money out into the real economy and use the ability of the federal government to print more money in order to accomplish those things.

That's not bank reserves in the Ben Bernanke or Kuroda-San style of QE. That's outright debt monetization or spending monetization, however you want to call it.

And, by the way, Professor Stephanie Kelton has the ear of a lot of politicians, especially on the Democratic side of the aisle, which is now taking power.

So it seems to me like, okay, you make a good point about what's happened before, Jeff. But what about what's coming? Aren't we headed toward a – I don't know if you want to call it QE, but aren't we headed toward money printing that really is money printing?

Jeff: That makes sense, right?

I mean, if the problem is that we have a block that's the banking system, because that's what the Fed does, the Fed conducts all of its activity with the banking system. That's where the bank reserves go, that's where the (quote, unquote) money printing of QE, that's where it ends up.

And so if the banking system is ultimately the problem, then why not just go around it, right? Let's screw the banking system, screw the central banks, we'll just take the government and do

the money printing directly with the people.

And that sounds like it should be inflationary, sounds like it should be more effective.

But we have to keep in mind – and I don't know Stephanie Kelton from anything, so I don't want to put words into her mouth or make a direct case against her – but these MMT proponents are just as clueless about how the monetary system actually works as central bankers.

And, really, what they're proposing is we're going to just take the central bank model and redevelop it for the Treasury department.

So we're going to do all this money printing stuff, we're going to have our DSGE models and we're just going to supplant them. We're going to take them from the central bank and put them in the Treasury department.

And why anybody thinks that's going to work out any better is beyond me. Because you have the same people who don't understand how, especially, the global end of the monetary system works.

And I don't believe anybody in MMT has ever talked about eurodollars and replacing the eurodollar system globally. So if you're going to start pumping dollars into the US economy what's going to happen to them in terms of their international existence, in terms of their international conditions?

And so what you have is essentially what sounds really good on paper, what sounds really good, like it's making progress and moving in the right direction but is functionally, technically, practically worthless in the same way that central banks operate today.

Because central bankers believe they know what they're doing too. And they're economists just like (I would presume) Stephanie Kelton is. And most of the MMT proponents are as well.

They have complex mathematical equations which tell them this is what's going to work, when, in fact, those complex mathematical equations aren't worth the computer space that they are put into.

So it's not really a matter of are they going to be printing money and moving it into the real economy. It's the mechanism by which they do so.

And so we have a flawed banking system that won't do it now. Why would we think that the Treasury department would be any better than the central bank at performing what essentially is a monetary redistribution role?

Which, by the way, is the exact reason the banking system took over the monetary role way

back in the ‘50s and ‘60s. Because that’s what the banking system does. It’s a redistribution mechanism.

Erik: Okay, Jeff. Hang on a second. You’re answering a different question than the one that’s on my mind.

You’re answering the question of will what Stephanie Kelton wants to do work and achieve the goals that she has in mind. That’s not my question. My question is will doing what she wants to do crash the US dollar? Because it really is money printing this time around.

Jeff: I don’t think it is money printing, number 1. And, number 2, you have to consider any kind of feedback effects. What happens to the existing system if the Treasury starts to do digital money printing, as you say?

I don’t think it will ever work out that way anyway, because now we’re introducing a political component into what should be a purely economic matter.

And I know you can argue that that’s essentially what central banks are as well. But that’s my point. You’re not really doing anything that’s much different. You’re trying a different redistribution channel than what we do today, what central bankers do now.

And so I don’t think it will lead to an inflationary eruption that destroys the dollar. And, by the way, the market doesn’t believe so either.

Again, we don’t see anything in inflation expectations. And everybody is well aware that MMT has become a very popular topic in political conversations, but yet the markets aren’t trading as if it’s any kind of realistic threat.

And whether they believe that MMT actually comes out and is anything that happens or whether it’s just not going to be effective, maybe that’s a different question. But I think overall right now, from what we understand and what we know, there is really nothing. MMT doesn’t really change much.

It changes the way we want this top-down model to work or at least the way its proponents want it to work. But I don’t think it actually changes the functionality of it.

And so that doesn’t to me describe the recipe for a dollar crash. It just describes more different ways to fail at the same level.

Erik: Well, Jeff, we’re going to have to leave it there in the interest of time. I can’t thank you enough for another terrific interview. Patrick Ceresna and I will be back as MacroVoices continues, right after this message from our sponsors.