Daniel Lacalle: The Situation in Europe is Worse Than You Think

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Erik: Joining me now is Daniel Lacalle, chief economist for Tressis SV and also CEO of Alpha Strategy. Daniel, I really am looking forward to this interview. I'll tell you, I've got a very extreme view myself on the situation in Europe. I think most analysts are under estimating how bad the situation is. I think the energy crisis is set to get worse. And particularly, I think that these are self inflicted wounds. I think that the problems Europe faces are of European policymakers own making. Vladimir Putin did a horrible thing by invading Ukraine. But he has not caused, as far as I'm concerned, any economic problem for Europe. I think that the economic problems that Europe faces were created by misplaced and misguided sanctions that were supposedly, I guess, in theory, somebody was stupid enough to think that they were going to hurt Russia. In reality, they have hurt Europeans and Americans and only helped Russia by increasing energy prices. Please tell me I'm wrong and it's really not as bad as I think.

Daniel: Thank you so much, Erik. It's a great pleasure to be here with you. And unfortunately, you're not wrong. I think that the problem in the European Union, it has been fully self inflicted. The European Union was already coming from not a particularly good recovery, the recovery was much slower than that of the United States or other developed nations, also, in terms of productivity growth, very, very poor. So that in itself was a bad start. But when the Ukraine crisis started, the European Union seemed to be implementing a number of measures that seem to forget that the world exists. And that, in that you cannot basically isolate Russia, because there is an entire east to which it can continue to sell its commodities. So the sanctions that were implemented, were, I think you've said the word misguided, which is completely correct is were basically implemented from a perspective of thinking that they would have no boomerang effect on the European Union, which was a mistake.

And second, that they would have massive impact on the Russian economy, without any outlet or without any improvement coming from higher demand from Asia, China, India, etc. So basically, most of the measures were implemented believing that the European Union could have some sort of a policy change that would make it inevitable for the Russian economy to collapse, and without any impact or any significant impact on the European economy. More importantly, when the European Union decided to implement restrictions and measures against Russia in terms of natural gas. What I found absolutely amazing is that they didn't look at the reality of supply and demand situation in the European Union, because the European Union cannot offset the loss of natural gas supplies from Russia. It's the so called dependency on Russian natural gas was a political decision. And it cannot be changed from one day to another, even less so with renewables. So the problem in the European Union right now is massively high energy prices for any US citizen, I just came back from Arizona. And for any US citizen, the prices that we pay for energy are not even something that they will even think of in the worst nightmare. But not just the price of energy is that the economic slowdown was already evident before the Ukraine crisis, that the policies implemented after COVID-19 were actually very negative for growth and that the European Union doesn't have the technology advantage that China or the United States has have in order to is to cement a different type of future. So it's a very difficult situation. It is much worse than what people perceive when I see some of the macroeconomic estimate for the European Union for 2022, and particularly for 2023. They are clearly ignoring that this is not a winter problem. This is a long term problem.

Erik: I just want to insert a note here for our listeners folks, please notice, the more smart guys we get on the show, the more that I try to challenge them with hey, look, I admittedly have crazy views. I know they sound really extreme. Tell me why I'm wrong. And you listen to a doctor Anas Alhaji expert on energy say no, it's actually worse than you think Erik. I told Dr. Pippa Malmgren who worked in the White House as a presidential adviser. What should I make of you know, another guest telling me that World War Three is coming? And she says, Did you read my post saying World War Three has already begun. Now, Daniel Lacalle is clearly an expert, macro guy in Europe, saying the same thing I'm saying, which is the situation is worse than most people think. Sorry Daniel, I just wanted to really get our listeners thinking about the trend here, because you're not the first really smart MacroVoices guest to say the situation is worse than the consensus seems to understand. Let's talk about this energy crisis and how we got here, because honestly, I don't get it. You had on television, you had even George Soros saying look, oil is fungible, you can't try to restrict it, it's not going to work. It doesn't make sense to me, or I guess what I'm trying to figure out is, is it actually possible that European policymakers are stupid enough in the face of plenty of advice that these sanctions were ill conceived and we're going to boomerang? Were they just virtue signaling trying to, you know, make their constituents make it look like they were doing something? Or do you think that EU policymakers were actually foolish enough to believe that the sanctions were going to work?

Daniel: It's a great question, because obviously, we it's very difficult to know. But I think that there were a number of telltale signs that showed that they actually thought that they were going to work and that China would come and join them. So pretty much like with energy policy, European Union leaders thought that if they started very aggressive sanctions, the United States would obviously join the UK, which is not in the European Union now, would also join. But I think that they were in some way, certainly foolish to think that China, India, and other countries would also join those sanctions. And I think that that was the big mistake. Because you can implement sanctions, you can implement financial sanctions against individuals, against companies and one can understand that, but you cannot just make a very aggressive bet on an important subject, such as energy without having enough ammo to defend your position. And the European Union decided to make a very aggressive bet against an energy giant like Russia is without having the ways to combat that position, with enough domestic and foreign support.

And I think that this was clearly well, and it comes also from a very political view about energy, which is the following. Many European leaders actually believe that you can simply switch off natural gas and oil consumption and start using wind and solar, and that everything is going to be exactly the same. Well, it is not. Wind and solar are great, but they're intermittent, and volatile, and they're unplannable. So it's impossible to offset, baseload energies, baseload technologies, nuclear, natural gas, oil, etc. And think that everything is going to be solved by renewables, but even less so with the way in which the energy matrix is constructed in the European Union. So that was clearly a problem.

The other problem, I think, is that many European Union leaders believed this law was going to be a very short one. So, they thought that implementing sanctions without really knowing what side effects or what negative effects that would have on the European Union economy, would have a devastating enough impact on Russia to stop the war by June because a lot of people that I've spoken with and politicians, etc. were absolutely convinced that by June everything would have ended. Obviously, that was not the case. Obviously, that was a very optimistic view about the Ukraine crisis. And certainly now it's very, very difficult to change that policy because politicians as you very well know, once they've implemented a policy, they will do anything to defend it, even if it has proven to be incorrect.

Erik: Well, let's really dig into that last point, because as you said, I agree with you that it seems that they badly misjudged the response of other countries, particularly China and so forth. But, you know, I don't see any evidence that they've learned any lesson from this. Even now, with the situation even after the Nord Stream pipeline sabotage has occurred. You've got, I think, a serious conversation going on in Germany, where there are actual grownups saying, well scratch our heads, maybe we should extend the life of our nuclear plants. But gosh, we were really committed for a green agenda, shutting them down at the end of the year. And it's a tough decision. What should we do? I mean, the notion that they're even thinking about doing anything other than maximizing the use of all assets that they have seems crazy to me.

Daniel: Oh, yeah. I don't get it. You don't get it! I don't get it! As I said, I just came from a trip to Arizona, nobody gets it, either. It's unbelievable. But I come back to the way that we started the conversation Erik, is that it's worse than what you just mentioned because think about this. Germany is in the worst energy crisis ever, not seen in the First World War and the Second World War, worst energy crisis. Okay. So obviously, they've been shutting down nuclear plants throughout all of these years. And you cannot bring those back, obviously, because those are gone. However, there are three nuclear reactors, that could still be operational that could be working today. Yet the government puts them on standby. Think about this, the government is so stubborn, even understanding that the policy mistakes have led to this situation, that instead of saying okay, we're going to use these nuclear reactors, let's put them to work to allow this winter and probably the next summer to be easier. They're not going to solve everything, but at least they're going to be something that that is going to help. No, they put it down, they put them on standby to show people that they are not backing down from the previous political decision. So that in itself is incredibly worrying. Now go to the Netherlands, you go to the Netherlands, where they have the largest natural gas field in the country. And instead of pouring that natural gas field to work, investing, and obviously compensating the citizens that live in the surrounding areas, because it's much cheaper than importing LNG from the United States, etc. No, they decide to continue with the phase out process of the field. So this is a clear case of politicians finding abruptly that the energy decisions have been incorrect and extremely dangerous in a situation of international crisis and continuing soldiering on with those decisions without any change.

In Spain, for example, the Spanish government the same, they have a nuclear shutdown program. They haven't changed it. The phase out of the nuclear plants is continuing. So, I come back to the point is that the is that they seem to be content with the idea that okay, we will shut down demand, we will force customers to shower, colder temperatures or not use heating. That is better than to admit that we were wrong about nuclear, that we were wrong about domestic gas. Think about this, Erik 15 years ago, which is yesterday, the European Union produced more natural gas than what the Russian energy complex exports today. This is insane. Yet, nobody is having a thoughtful discussion in the European Union. And this comes back to all the political landscape. It's not just the left or the right, it's both sides. Nobody is saying look, we made a huge mistake. We need to develop our own resources. We need to strengthen our security of supply. We need to have all technologies working. And while we continue to invest in renewables and we continue to invest in clean energy, which is absolutely fine, we need to understand that energy policy has to be based on two things, which is affordability, and security of supply. And those two pillars of energy policy have been completely abandoned and ignored by the political landscape in the European Union.

Erik: Daniel, let's talk specifically about Germany and the situation there. You know, the way I thought this was set to go down, was okay, they're going to talk tough, and we're going to get tough with Russia. The politicians say what the voters want to hear and then when the weather gets cold, somebody's going to cave. They're going to make a deal with Russia, they're going to turn Nord Stream back on, and they're going to get their gas. Then someone sabotaged the Nord Stream pipeline. Now, Senator Dick Black, the Virginia Republican who served in the US Senate through 2020, has a video out this week on YouTube, in which he explains his background as a former criminal prosecutor and says, look, I'm trained to think in terms of means and motive. And to do such a sophisticated attack on that pipeline, it really looks like one of two things has to be true. Either the United States did this, or the United States helped someone else such as Ukraine or Poland do it with United States military assistance. There's even some flight radar 24 tracking where a bunch of US military helicopters were circling over the area where the bombing of the pipeline happened before it occurred. They had traced back the serial numbers or figured out somehow, from the flight tracking data that US military had aircraft actively operating in the area before that attack occurred. What would it mean, if it were proven that the United States either was responsible for this or aided and abetted someone else in blowing up the Nord Stream pipeline? It seems to me that that would permanently damage US-German relations. And I think it should, frankly, I think that it puts Germany in an incredibly perilous situation, you know, German people don't deserve to freeze to death, because politicians can't seem to work out a deal. Am I missing something or how would you interpret the implications if it turns out that the United States helped to facilitate this attack on Nord Stream?

Daniel: If it's obviously proven, it's going to be a huge blow to the, to the position that the European Union maintains with the United States. However, I think it's very unlikely that we will see a big shift in the way in which Germany and the rest of the European Union countries have even if that is if even if this piece of of information was proven to be true, it would be very difficult for the European Union to radically change their position towards the United States for a very simple reason is that the European Union decided many, many decades ago, to subcontract its security to the United States. And they don't have any alternative. So there's no alternative that the real problem here is not dissimilar to the dependency on Russian gas. The dependency on Russian gas was a political decision. The German government perceived that having a strong dependency on Russian natural gas was on the one hand and that was absolutely true. A cheap alternative because it was and remains the cheapest alternative in terms of energy consumption for Germany, much, much cheaper than solar and wind today, obviously, we will see what happens in the future. And because also it was perceived that developing strong commercial relationships with Russia would facilitate an improvement in the way in which the political situation would develop in terms of the different political views of the governments and obviously that was a mistake.

But in the case of the United States, and the European Union and NATO itself. I don't think that there's any alternative. I don't think that there's any alternative because it's thinking many years ago, I think it was President Trump but also president of I mentioned it was that the position in terms of defense of most European Union countries, and Germany in particular, is so weak that there's no other option. So it would definitely create a gigantic diplomatic problem. But not something that could lead easily to decisive actions that would radically change the current position. So it's a very difficult one. If it is proven to be true, I can tell you that it would generate a tremendous level of discontent. But obviously very difficult. It's a very, very difficult one to answer to be fairly honest.

Erik: Let's talk about where this whole situation is headed in terms of Europe's future, it seems to me like the energy crisis is only set to get worse, I don't see policymakers changing direction, as you say, there, if anything, just trying to defend their policy mistakes, rather than correcting course, I predicted early in the summer, that Putin would wait till October or so and turn the gas off. Turns out he did it in September, I didn't see the pipeline being taken out happening. But that's, you know, the option to turn it back on now, after negotiation has been eliminated, apparently, intentionally by someone who is a state actor, it seems from everything I'm hearing, it would not be possible for anyone other than a state actor to have done this attack on the pipeline. That's going to create, I'm sure more hardship than most people realize is coming for Europe in the next two years. How much hardship is that? Are we talking about existential threat to the European Union and or the currency? Or are we just talking about a really bad recession? What does it mean?

Daniel: It means a very bad recession, I don't think it's the end of the European Union or the currency, or the euro. Because I come back to the points that I made before, if you look at the political landscape, from the left to the right, those are things that are not under threat, even after the elections in Italy. So that's one thing, but certainly a much, much deeper crisis than what people are estimating. We are not seeing yet the figures that are likely to saw in the next month of businesses closing, because they simply cannot pay the energy bills. We have seen some examples of businesses that have gone from paying 2000 euros a month for energy to 8000. The average household Bill has risen between 50 to 70% in natural gas, and in power, around 30 to 50%. But those obviously, are still figures that don't show the impact of an entire year, because those contracts, many of them are still linked to futures markets that have not been renegotiated by the suppliers. So the problem is going to start actually, after the winter, because right now, many households, many businesses are able to sort of survive with extremely elevated prices. And we're talking here about three times the price that the United States household pays in some cases. So one of the things that we're likely to see is that after the winter, a lot of those long term contracts that are still informing the price that consumers are paying for the electricity or natural gas will have to be renegotiated even at the current natural gas prices in Europe, which are at $150 per megawatt hour more or less and the current power prices so that is when the problem is going to start. And the problem again, is not a winter problem, because a winter problem is a problem of price. But we are not talking about a problem of price and supply at the same time. Right now, it's a luxury that one can afford. As you know, Joe Cocker used to say it's a luxury you can afford but barely. But in the next months, what is likely to happen is that a problem of price is added to a problem of supply because the LNG market cannot offset Russian gas for an entire year.

As you know, the LNG market, the liquefied natural gas market is extremely thin, and most of the LNG is contracted. So what a basically a one can do right now, which is to import a lot more from the United States. And this is actually something that I find also ironic and fascinating about politics is that the European Union now is importing is the largest importer of liquefied natural gas from the United States, in natural gas that is produced with fracking that is banned in the European Union. So that comes back to what we were talking about before, is that the European Union has banned the development of its own natural gas resources, while at the same time paying exorbitant amounts of money for gas produced with that same technology in the United States. However, demand in the United States is going up, prices in the United States are high. So it's not going to be easy to accommodate the growing demand of the United States with the security of supply solution of a problem in the European Union. That is, that extends beyond this winter, right now. Storage is elevated about 80% level of storage in most European Union countries. So that will likely support a decent level of security of supply, it seems like it's going to be a mild winter, which certainly helps.

So now, in the next three months, it is a problem, it looks to be like it's going to be a problem of price alone. But in the following months, it will likely be a problem of supply and price. That means businesses closing, unemployment rising, industries leaving the European Union because they simply cannot continue to work with the elevated levels of price. And I come back to the point about politicians, again, because think about this. Yes, natural gas prices, soaring, electricity prices soaring. Absolutely, but the average household pays about 70 to 75% of an overall bill in taxes and surcharges. So politicians haven't changed any of that even on the face of a wave of bankruptcies and businesses, and a rise in unemployment.

Erik: Let's talk about that policy response because it seems to me that in Europe, and to some extent, also in the United States, and in the UK, the policy response seems to be Yeah, we've got a serious inflation problem. And as Joe Biden put it, you got to credit the man with the quote that I'll never forget. You don't have to worry about the inflation because we're gonna pump so much money into it that it won't matter. President Biden obviously showcasing his PhD in Economics from Fred Flintstone University. Liz Truss seems to be even stupider than Joe Biden, when it comes to understanding inflation. They want to use subsidies handouts in order to solve what really is a problem where they need to focus on demand destruction. The supply is unfortunately, they can't do anything about it, there's no choice but to bring demand down. And what they want to do is offer subsidies reducing the financial incentive for Europeans to conserve energy. At the same time, they're talking about price controls, which you and I know is a guaranteed recipe to lead to shortages and outages not to allow people to continue to buy unlimited supplies of anything at a price. It just guarantees that you won't be allowed to buy it at any price. It seems that all of these lessons that have been so well learned through anyone who has studied history are completely lost on the people in charge. What is it going to mean economically? It seems like inflation, I would think would be set to maybe start to really run away particularly in the EU as they continue to try to stimulate their way through a problem. That stimulus only worsens. Have I got it wrong?

Daniel: No, you haven't! The biggest problem of the consensus estimates of inflation, which as they always do, are rapidly estimating decrease to around 2% by next year, is that in order to get to that level, one would need to look at the individual prices that comprise the CPI basket and think what will it take to get to 2% if the government's all over the world and developed nations, as you mentioned, what they're doing to combat inflation is to spend more increase deficit spending, which means more units of currency being issued, which means higher debt that is going to be monetized. And at the same time, the central banks of those countries are trying to, quote unquote, defend their currencies by selling reserves US dollars. So think about this, it's almost impossible to bring down inflation in that environment. But you mentioned the concept of lessons learned. And I think that there's absolutely no lesson learned when you think of what the UK Government has presented as a package of measures to combat inflation, they're all inflationary measures. But it's the same in Germany, it's the same in France, it's the same in Spain and Italy, and it's certainly the same in the United States. Government spending is driving the entire response to the crisis. Government spending that is financed with higher consumption of newly created currency units.

So I think that governments will always move to implement policies that look simple, and that look easy to implement and definitive in terms of the action. But they don't work like price controls. Price controls, the easiest thing to present to the public. They go on TV, and they say, ah, the price of food is too high. We're going to implement price controls on supermarkets that you get, and then and why do they not learn those lessons that you and I or anybody that knows anything about economics can easily show that they don't work. First, because when they don't work, the government is never to blame. So imagine you implement price controls, supermarkets suddenly stop having the products that you require at any price. And then who do you blame? The supermarkets... the great thing...

Erik: Those greedy bastards!

Daniel: Absolutely. The great thing about inflation, which is the tax on the poor, is that inflation and all of its consequences, and policy responses, and all of their consequences are always the blame is always shifted to somebody else. Right now, you hear Whoa, inflation. Why is there so much inflation, the blame was on Putin, the blame is on war, the blame is on China, the blame is on supply chain disruptions. The blame is on businesses. Now, Elizabeth Warren was saying that businesses are increasing their margins even though reality shows you that that is not the case. So the great thing for a politician about this horrific environment that we're living in, is that they can always shift the blame to somebody else. If supermarkets don't stack up products, when they impose price controls, the blame is on supermarkets. If the price of gasoline goes up, the blame is on OPEC. If the price of your rent goes up, it's the blame is on the landlord. So except printing money like there's no tomorrow. And the other beautiful thing for governments is that they have an absolutely endless list of economists and experts, they're willing to say that the problem is everything else and anything else except printing money, because that is another big problem. Another big problem is that you have a great deal of perverse incentives and within the expert population that know that all these things don't work that come and say and because of their allegiance or their support or their work with governments, they will defend those policies. I find it amazing to see an economist like Miss Mazzucato saying that there is a great tool that we have not used yet, which is price controls. Unbelievable.

Erik: Okay, so in Europe, we have a very dire situation and we have European policymakers hard at work. I think you and I agree doing everything possible to make the situation worse. I want to step back though and talk about where we're headed with this energy crisis. This because people talk about this dire European energy crisis. Daniel, I don't think there is a European energy crisis, I think Europe is where we're seeing the first and most visible signs of a global energy crisis. And specifically, my prediction is that as China comes out of its zero COVID policy, and that economy gets restarted, I think that the entire world is going to experience an energy crisis every bit as bad if not worse than what Europe has already seen. And the same kind of price increases that have occurred in Europe are going to hit the entire global economy.

The reasons that I say that are that we simply have not made reinvestment that needs to be made in fossil fuels. Essentially, government policy is so committed to their ideological views about wind and solar, that they're anxious to phase out fossil fuels before phasing in a viable replacement. And the result because of policies that have disfavored the investment in exploration and production of oil and gas, is that we are out of spare capacity already. And I contend it is not possible for the global economy to return to pre-pandemic normal because energy supply simply does not exist to get us there. You have written books on energy and energy policy. What do you think about what I just said? Am I exaggerating? Is it really not that bad?

Daniel: No, no, it is that bad. It is certainly that bad. Because when we look at the energy landscape, and the picture of supply and demand, many of us tend to forget, a key element that you just mentioned, which is the China's growth is severely damaged by the zero COVID policy and the shutdowns of about 30% of its GDP in the number of cities that have been in different stages of lockdown. So when everybody's looking at supply and demand, they're looking at a supply and demand picture in which they are big holes of uncertainty and recovery of China would certainly bring an elevated level of stress to that supply-demand picture.

There's also the inevitability of what happens when you spend a decade underinvesting in energy is that it doesn't come back quickly. And there's about 650 billion a year under investment in fossil fuels, that is essential not just to attend the current demand, but also to maintain a flow of natural gas and oil, that is enough to avoid significant shortages in the near future. And this is the first energy transition ever in history that has happened that this happening because of a political decision not because of an industrial decision. The reason why whale oil was substituted by Crude Oil was because it was cheaper, easier to produce, and certainly easier to transport and to store.

So, that led to a massive energy revolution. The reason why natural gas became an important and absolutely critical substitute to coal was again for the same reason, because it was industrially viable, easier to transport, easier to store and cheaper to produce. So all these factors have been forgotten in the decision. The political decision that wind and solar are the only options that can be thought about would start like all political decisions by ignoring the mining aspect of wind and solar. The requirements of copper, of rare earths, of aluminum, etc. The problem therefore, is that, as the world, developed nations, shift the energy mix to a larger proportion that is based on technologies that are volatile and intermittent. The cost of the system rises dramatically because you need backup, because you need much higher levels of investment in distribution, networks, etc.

And obviously, because being intermittent you need to have two, three times more available capacity for the same level of production. So, natural gas was sort of the the gel that kept all of this more or less in an acceptable level for the consumer, until the percentage of intermittent and volatile technologies becomes too large, and therefore, not even natural gas works as the as the gel to that process of transition. And everyone can talk about batteries and different storage options for renewables. But those are way far from where we are today in terms of industrially available options,. And certainly, we are not even discussing the mining aspect and level of dependency on other commodities that that would require fundamentally copper, but also the, you know, as I mentioned before rare earths and so many others, lithium, etc.

So it's a very difficult process and it's a very difficult process only because it's pre-designed politically, because this process would be, would happen whenever it has to happen. When technology, industry, competition, and innovation provide the solutions. But when the solution is predetermined by a political decision, and excludes every other, it is basically for an breaks on innovation. To start with, I find it almost astonishing to think that today, years and years and years after the wind and solar have started to develop solar panels continue to be those massively inefficient and hugely consuming in terms of size, everything compared to what what they should be, think about why our phones are smaller and more efficient and provide more services. Because competition, innovation is constantly looking for solutions to things that we would not even dare to believe, when, when I was when I started working in I had a phone, which was the size of a small piece of luggage. All of those things have happened because competition, innovation technology have been allowed to reach the best solution for consumers. However, this transition has been politically designed. And by that because of that, it is industrially flawed and is extremely onerous on the consumer.

Erik: Daniel, we're talking about some really profound fundamental drivers for financial markets here. But you know, if there's anything that the last 10 years have taught us is actually the reaction of central banks to those fundamental drivers that tends to move markets more than the fundamentals themselves. So let's talk about what this means in the sense that central bankers were all kind of telling the same story, or maybe it was the same bluff of, hey, look, we got to tighten, we got to fight inflation. We're not going to pivot, we're not going to pivot, we're not going to pivot. Oh wait, our currency and in the case of the UK just collapsed in the course of two minutes and you know, some huge percentage. We changed our mind, maybe we are going to pivot. Is that coming from the rest of the central banks? Is that what we should expect? Obviously, how do you time that? You know, it's gonna move markets in a huge way. It's something that's very hard to anticipate, unless you're an insider and I'm sure there are plenty of those. Am I right to think that central banks are the right place for us as investors to be thinking about what we should be putting our attention on? And if so, okay, once you get your crystal ball, well tell me what the central bankers are going to do next.

Daniel: Of course they're going to pivot. Of course, they're going to pivot but we should not think that that is the catalyst for markets to strengthen, because they're going to pivot reacting to something that is happening in a moment in which most central bankers, I've had the pleasure of knowing a few of them. They're all in shock seeing markets collapse, when they know that their policy is monstrously accommodative. So central bankers thought that hiking rates and explaining it well in advance and announce it endlessly all over the place well in advance, etc. But at the same time, not changing dramatically at all. In fact, the balance sheet of the central bank continuing with reverse repo operations continuing with liquidity injections, like the Central Bank of England and the Bank of Japan, etc. That would be an environment that would be conducive to making investors understand that the policy remains accommodative. And that hiking rates is just a tool to cool down inflation, okay.

And they're in shock, because they see bonds collapsing. The worst bond market since we have, I think that since we have any memory now. They're seeing pension funds losing money in nominal and in real terms. They're seeing equity markets collapse. So it's a very challenging situation for the central bank that had designed a way out to combat inflation that was clearly built to be perceived as hugely accommodative, and see all investors suddenly go into panic. So that's why the pivoting is not going to work. Because the pivoting comes from a non-pivoting if that makes any sense. It comes from being hugely aggressive in terms of monetary policy.

Today, think about the European Central Bank was showing the other day its monetary aggregates, and money supply growth in the European Union right now in the Eurozone sorry, is higher than what we called the Draghi Bazooka in 2014.

So those central bankers are thinking, why our markets collapsing when we are doing more than what Draghi said, is more than enough. You see what I mean? So the problem is that the market is extremely tight, not just to loose monetary policy, which is what we have today but to incrementally loose monetary policy at unprecedented scales. And think about this, when in 2020, Central Bank's announced their injections, their monetary injections to combat the risk of deflation, to combat the risk of deflation, when you have everybody locked down in itself is such a level of stupidity. That doesn't even start to come into the radar. But that's another topic.

But think about this, there should have been already signs that they were going crazy when announcements of a trillion dollar program did not generate any reaction from markets. Then you have to announce 10, 15, 20 trillion dollar programs. By the time the programs were 20 trillion markets started to react. So the problem is that pivoting is not enough to come back to a process of multiple expansion that was created from nothing. That was created in a period in which we have discussed this so many times you and I. You know, earnings growth was coming down, earnings revisions were negative over and over and over, etc. So, of course they are going to pivot and what I'm afraid is that once they pivot, and you see and you will see it a burst up of markets. It is very likely that markets will resume the week afterwards because the problem created by this monster negative carry trade against the dollar has not been solved. And it's not being sold either by the response of other central banks, which creates a higher negative carry on the US dollar.

Erik: From everything we've discussed Daniel, needless to say we live in interesting times. But boy, where do you put the trades on here? Because there's just so many moving pieces. This is so daunting. It seems to me that you could see really, really huge volatility in either direction, depending on how a central bank policy decision happens to be made that you have no have control over or ability to anticipate. You've been in this business a long time. What do you do in this environment as an investor? What's the trade to put on here?

Daniel: I think that this is an environment in which you need to look at the overall picture. And think that you need to be exposed to the US dollar. And you need to be exposed to the commodity cycle, and you need to be exposed to gold and silver which currently are underperforming in dollar terms but outperforming massively in Pounds, Euros, Yen's, and other currencies. I think you have need to have those, which I call defense in a portfolio in a team. I also think that you need to in terms of the cycle, you need to be extremely aware of the risks in Financials. You need to be extremely aware of the risk in what I call sectors that are so called strategic or that are that have positioned rent, because those are going to be the ones that will be penalized by policy. So utilities, telecoms, you need to be very, very, very aware of the risk of government intervention and government restrictions in those sectors. And so if you stay away from financial stay away from the retail side of utilities and the retail side of telecoms, there are plenty of good opportunities, even in technology. Everybody's looking at the NASDAQ collapse.

But in technology, we'll look at artificial intelligence, look at things that are going to drive the innovation process in the next years. Companies that are generating profits today and that are generating good margins today, they are good things to look at.

And I think that the bond route is likely to continue. So we're not exposed. We're underweight sovereign bonds and also high yield bonds. I think that those are the riskier side of the bond spectrum. But again, I come back to the point in investment grade, you're starting to see good opportunities in companies that have good cash flows and strong balance sheets. So you know basically, I think what we need to do is to invest in those segments that are least exposed to the monetary laughing gas we have seen in the past, which is those that need multiple expansion to justify very poor earnings and very poor margins, and those that need monetary life and gas as well to justify yields that are completely detached from solvency and liquidity reality.

Erik: Daniel you mentioned the US dollar, I want to come back to that because a couple of weeks ago, I said to our listeners on this show look the US Dollar Index just took a parabolic turn up. What that usually means, what most traders are telling you is it's time to short it because it's going to be a blow off top and probably a trend reversal. And what I said to our listeners is, yeah, that's probably the most likely case. But I'm telling you, I got a hunch in this case, we should keep a close eye on this. Because if it doesn't blow off, and particularly if it goes over 120, which was the high from I forget how many years ago. You know, new all time highs is always bullish for anything. And boy there's a certain level, I'm not sure where it is when 120-125 where the US dollar completely breaks the entire global economy. Am I right to think that there is a level where if the US dollar gets to a certain level, it is going to completely break the economy? And if so, what level is that?

Daniel: I don't know what level. I know that the DXY is mostly against the Yen and the Euro. And I don't see any way in which the Bank of Japan, the European Central Bank, the Eurozone as an economy or Japan as an economy are likely to reverse the trend that has started in terms of strengthening of the US dollar weakening of which is actually not strengthening of the US dollar because the US dollar purchasing power is coming down. It's strengthening relative to others. So the problem of taking a bet against the US dollar is that you're taking a massive bet against central banks that are actually doing everything that they can to continue to debase their currency,, a European Central Bank and the the Bank of Japan. Even if they say that they're worried about their currency, they're actually not. Because they continue to believe the fallacy of weaker currency means more exports, which is again, something that doesn't work.

But in any case, the other problem is fund flows. To bet on a weakening of the US dollar, you need to bet more than on the Fed pivoting. You need to bet on the increase in dollar based debt that has happened in the last years, plus the increase in exposure to US dollar trading, commodities, etc. to revert completely. That is huge. Think about this, you're talking in a world that is about 90 trillion of global liquidity, you're basically making a bet that about 10% of that is going to revert out of the dollar and into weak currencies. And the way to think and if you're betting on that, you need to think that investors globally are going to find it less risky to be in the Euro, the Yen, the Pound, the Turkish Lira, the Argentine Peso, you name it, it doesn't matter, then in the US dollar while the challenges that we talked about in energy and in the currencies of those other economies are higher than those of the United States. It makes no sense to me for a while.

Erik: Well Daniel, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners how they can follow your work. And we do also have a large audience of both accredited and institutional investors who are qualified to invest in hedge funds. For people who want to find out what you do at Tressis SV, how should they contact you?

Daniel: The best way to contact me is via Twitter. I have my Twitter account is @dlacalle_IA, my website dlacalle.com/en in English. My YouTube page Daniel Lacalle in English. So as I always say it's easier to find me than to avoid me so not a challenge to find me.

Erik: Patrick Ceresna, Nick Galarnyk and I will be back as MacroVoices continues right after this.