MACRO Voices
with hedge fund manager Erik Townsend

# Russell Napier: Knock-on Effects of Secular Inflation

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***Erik:*** Joining me now is best selling author and advisor to many financial institutions, Russell Napier. Russell, it is great to get you back on the show, I know you've got a new book out, which I'm really excited to read. It's called "The Asian Financial Crisis from 1995 through 1998: The Birth of the Age of Debt". And I'm waiting, actually, for the audio book to come out in a couple of weeks so that I can listen, which is my preferred format, rather than read, but it's available to order right now.

I want to talk first, you know, we've been talking to every guest about this inflation-deflation debate. You were one of the first people to really tell us, hey, it's time to just have a secular shift in thinking because we've got a secular shift toward inflation and you've been a very outspoken deflationists for many years. I've really been looking forward to asking you this. Does the situation in China change your tune because that's turning some people back to deflationists?

***Russell:*** Sure. So the answer in any intermediate timeframe and long term timeframe is no. But, let me discuss the situation in general, because it is currently somewhat deflationary and to get worse before it gets better. The question is why? And the answer is because they have a managed exchange rate, which for many years actually has been keeping monetary policy too tight. If you look at the People's Bank of China balance sheet, it's one of the few that hasn't grown. In fact, it's not much bigger than it was in 2017. Which when you think what has happened in Japan, the European Union, America, the United Kingdom, is quite remarkable. Not many people look at that and say, well, that's a choice of people at the Bank of China. That isn't a choice. It's forced upon them, because they have a managed exchange rate, which controls the size of the PBOC balance sheet. Now there are mitigating factors like capital controls, but that is the bottom line. Broad money growth in China just about over 8% is one of the lowest levels ever recorded. These are the classic situations in which you'd expect to get to some sort of credit crisis and that's what we've got.

Now, obviously, property has been overbuilt in China for many years. Already in the book that the Thai property market was clearly overbuilding in 1993. But we didn't get a catalyst to reveal that until 1997. Well now we have the catalysts for China. And that is that monetary policy is too tight. So here's the bottom line, does China accept this tight monetary policy that has been forced upon it by targeting the exchange rate on the basis that you target one monetary variable at a time or do they do something about it? So here's my call, this is a property crisis. It looks like a property crisis but ultimately, it's an exchange rate crisis. Everybody knows what you do

when you have a decline in property prices or a credit crisis associated with risk in the property market. That is the main form of collateral across the financial system and the banking system and the non-banking system. And here's what we do, you cut interest rates and you print money. That's what you do. And there's no reason to think that just because Xi Jinping is unelected that he would follow a different path. So the question obviously isn't timing which we can go back and discuss.

So my view is that we don't go far down the path of in the property market, lower Chinese growth, something that looks like a credit crisis, until Xi has to move to what everybody does in a situation like this. Now, just one more minute on that. It does mean a lower exchange rate. If Xi cuts interest rates and increases the supply of money. It will give you a deflation shock. To the markets, we'll see that as deflationary. But it is actually very inflationary, and is inflationary for three key reasons. Number one, tariffs. There will be tariffs again. So this is not 1994 China everybody, this is a economy. The world will have to cope with the consequences of China pouring cheap products, and all returns into the world. Number two, it's only happening because China is printing a lot of money and it takes a while to get to consumer goods and consumer price inflation but it does get there.

And number three, it kickstarts a huge capital investment boom into the rest of the world as we tried to replace all the stuff we're not buying from China. So that may sound like a complicated roadmap, because it is complicated by the fact that it's difficult to be right on the timing. So there may be one more deflation shock. It doesn't make me want to move away from my call for inflation, nor particularly change the portfolio because I think it'll be very, very quickly. But people will begin to realize that this time, unlike 1994, there's movement on the Chinese exchange that is actually not deflationary, but ultimately is inflationary. And finally, it really does trigger the cold war. It's really a case of forcing everyone to take a side. Do you devalue with China or do you not devalue with China because of the great pressure from the developed world not to do that. So a little hiccup in the road. But that doesn't make me change my portfolio because basically I don't think I'm smart enough or quick enough maybe to know how to play that and getting back in when we have this final wrinkle on the deflationary shock.

***Erik:*** Okay, Russell, what I'm hearing is you're really basically sticking to your story on the secular inflation call, but also acknowledging that China could give us kind of a little whiff of deflation before the inflation really gets going. Let's move on to when the inflation really does get going. Because I hear so many different perspectives and people have different views that range from, look, the only connection between interest rates and inflation is the one that the central banks intentionally create by raising interest rates to fight inflation. And interest rates don't need to move with inflation unless the central bank commands it. Other people would say that's a natural relationship. And still other people would say the central bank needs to do everything it can to prevent rates from following inflation as they normally would in typical cycles. Which one is it? But also what's the right prescription? And what's going to happen here, because frankly, I think central bankers all over the world aren't really sure what they're doing, and they're trying to figure out their next move.

***Russell:*** Yeah, I go slightly further than that, and say that they're impotent. That they can't do anything. They can talk it but they can't walk the walk and here's the reason why. It's not that higher interest rates are just unacceptable and they are. They're not unacceptable, they're usually pretty unacceptable anyway to most people. But they aren't acceptable now, because the Debt-to-GDP ratios are so high, and they can cause huge havoc. I mean, the Debt-to-GDP is also well worth looking at from the private sector debt service ratio, interest rates right now. Maybe we can carry even more debt than before. But actually, there are certain countries that really jump off the page with even low interest rates, where the debt service ratio is too high, China would be one of those in fact. France would be another. Canada would be almost top of the list. In other words, we, you know, it's it's like Jack Nicholson in "A Few Good Men." You want the truth, you can't handle the truth. We can't simply accept it.

Interestingly, America can move slightly higher with interest rates, its debt service ratio is way far below. [inaudible] There can be some reason to raise interest rates, but clearly not to a level that reflects current levels of inflation. So that is the absolutely key question. The question is not what is inflation? The question is, when, again, will we live in a system where interest rates can reflect the prevailing rate of inflation? I obviously think inflation is going to be high, and therefore I think interest rates would have to be higher still. However, it's not going to happen. Now the question is, how do they stop it? It's not about central bankers and short term rates, it's about what we used to call market determined rates. And I said used to call because there is this yield curve. And that yield curve is at least as important in terms of interest rates as the short term rate controlled by the central bankers. At the minute, we all know how they're controlling it. They expand the balance sheets and central banks buy that debt and hold on to yield. That's where we are permitted. In the long run, you simply can't do that. And it's not that you don't have the power to do it because of course you do, you can expand your balance sheet to infinity. The reason that you have to stop is that liquidity you are creating is adding to the inflationary mess. And you don't want to create that liquidity that adds to deflationary mess. And that didn't happen from 2009 to 2019. But I think it's already happening, we can see it in inflation and this is something we've talked about before.

So at that stage, it has to stop being a central bank, and it becomes citizen institutions. You have to force savings institutions to buy those government bonds, because they don't create any liquidity when they buy the government bonds. You're not adding liquidity to the system. You stop using the central bank and you force the savings institutions to do that. That's what I call phase two financial repression. It's bad for equities, because these institutions are not like a central bank, they have a finite amount of money. If you're gonna buy something, they'll have to sell something and what are they gonna sell? It's primarily in equities. And then finally, why central banks actually impotent? Why are they now irrelevant? They don't control the supply of money anyway. Go to the Bank of England website, you'll find a lovely article on how money is created on side the obvious. Unfortunately, all the money in the world is being created by commercial banks. And if the governments get control of the commercial banks, and can influence the rate at which the commercial banks expand their balance sheets. Then the governments can control the supply of money and he or she controls the supply of money controlled monetary policy. So the central bank will simply go on impotently. The long term

interest rate will be set by the regulator. They will force the institution to buy it and supply of money will be determined by the government who controls the growth of commercial bank credit. And the central bank will be set in writing interesting papers about how to control monetary policy.

***Erik:*** I want to integrate these last two topics that we've discussed, Russell because when you were talking about China, your conclusion was that central bankers are going to be confronted with a situation where they are forced. Their hand is being forced to deal with this FX issue that you anticipate existing for China. Well, okay, wait a minute, it sounds like what you just said about the challenges that central bankers are going to face dealing with inflation starting to run away. How are they going to stop the rates? It seems like those are integrated. So to what extent could there be surprises or curveballs that China throws at central bankers that limit or curb their ability to deal with this inflation?

***Russell:*** And that's a very good point, because it really depends on the PBOC itself. So there are curveballs that could be filling out the central banks. For instance, if I'm wrong, let's say Xi Jinping actually likes lower growth, likes deflation, likes the fact that certain organizations are going bankrupt and actually going into government control. Well, that's going to create for the central bankers with interest rates at zero, that's going to create certain problems. However, it's the governments that respond to that. And the government's would simply force the same for the commercial banks to lend more money and create more money. My fundamental thesis is that the PBOC contributes to inflation. But that's a curveball if you like when they're being dealt by their own government anyway. So it exacerbates it. But you know, where I could be wrong is that Xi likes this form of forcing off its private sector into the public sector. And that's a huge curveball for central bankers, because there's really nowhere else to go. And just to be clear, there is an answer to this. And the answer is take power away from central bankers, and that has been the answer now for 18 months. And I can't think of a different way to split this, whether you think there's a deflation shock first, or the PBOC just prints a lot of money, and we got inflation.

Either way, the answer to this is take power away from the central bankers and pass it to the governments. I've been making forecasts for the public realm for over 25 years, you don't always have the same degree of confidence in your forecast. But that monetary policy is passing to the hands of the government and away from central bankers seems to be the most obvious thing we can say. And yet, if I pick up the financial newspaper, look at the front page of Bloomberg, the first five stories will be about the Federal Reserve. There's kind of a muscle memory here, that tells us the central bank controls these things. And whether it's passing to PBOC, or whether it's passing to the indigenous governments in the developed world. It's not their realm any more there, this is not the realm before 1942 to 1951. In America, nobody bothered what the Federal Reserve was doing because it wasn't relevant. I looked at what the government was doing in terms of mandating the functions of government bonds. So all road leads to the same place, which is the impotency of central banking.

***Erik:*** Russell, I couldn't possibly agree with you more personally, that taking power away from central bankers ought to be the answer here. But frankly, there's a lot of things that I think ought to be the answers that I know perfectly well are simply not politically viable in this environment. You know, when I hear my libertarian friends talking about how things should be, it's like, Okay, if you want to tell yourself that you'd like it better that way. That's an interesting mental masturbation exercise. But as far as it actually happening on this planet, the trend is very much toward collectivism. It's very much moving away from capitalism. A lot of younger people really think socialism is appealing. There's MMT, all of the trends that seem to actually be active are telling me that as much as you might want to see central bankers have power taken away from them. I think the actual trend here is exactly the opposite. Would you agree with that? And if so, what are the consequences? I mean, how's this thing gonna turn out?

***Russell:*** Yeah, so I do agree with that. But of course, your libertarian friends think it should be taken away from central bankers and passed to the private sector. That's, you know, that's what they want to see. And that's perhaps why they own Bitcoin, because that's a private sector currency. But you're right. With foreign central bankers, it's not leaving central bankers because suddenly the government have decided the private sector will be much better at doing this stuff. Quite the reverse. It's leaving central bankers and going to government, because the government has to achieve similar things you've just mentioned. Pretty high up off the list is the redistribution of wealth. Probably even higher than that is a green investment. Now, the market may or may not provide those things, but the government's running out of patience to allow central bankers to turning the price of money on hope that the market delivers these things.

So I'm afraid for your friends who think power should be taken from central bankers. It's going in the wrong direction. It's not adding to the market. It's quite clearly adding to the governments to meet the green investment boom and to meet the redistribution of wealth. And frankly, to move wealth away from savers to debtors, which is not really the dream of people who foresee that there is no central bank one day. They foresee their hard money, a world of hard money debtors are paid back in dollars, which have the same purchasing power which they rent. So yeah, they're right parties moving central bankers. But it's not going to do direction that they think and it's inevitable. As you say, We're not here to forecast what we want. We're here to forecast what is likely. And what is likely in all the forecasts that I've talked about so far are all based on politics. And the problem is simple. The debt-to-GDP ratio is so high, that debt has to be inflated away. And you do not inflated away by handing the power to grant money to independent central bankers, nor the private sector for cryptocurrencies.

***Erik:*** Well, since we're in the business of translating all this stuff to outlooks people can make money from. What do you get when you grok this all together Russell and think about an outlook for bond rates? Is the 35 year bond bull market finally over and if so, does that mean that a bond bear market has to start? Or do we just stay at this sort of low rate situation for years to come?

***Russell:*** Yeah, that's a great question, isn't it? Because in a market determined interest rate, you'd expect interest rates to go up to reflect inflation. But if I'm saying to you, they're not

allowed to, then actually, you don't lose money on bonds in nominal terms. And that's not to say you can't lose a little bit in a few year and a half or whatever. Bond yields can go up higher and it might be lower a little bit first of China devalues then it will go higher. But the bottom line is your losses in bonds are in real terms and not in nominal terms. At the outside of this call, I said that very clearly. We can't live with a [inaudible] response, we can live with bond yields 5, 10, 15%, so we're not going to get them. So those great losses that you made on bonds simply aren't going to happen. But that definitely does not make the price because the losses come in real terms but they come over certificates of confiscation. But that confiscation comes in real time. So we are absolutely in a broad bear market. But I think we should measure volume weighted by markets in real returns. We should measure everything in real returns anyway. But I think the real returns for bonds will be shocking. For at least 15 to 20 years but actually in nominal returns may not be to be just be flat. That's what happens if you count the yield curve. There is no, there's no volatility, there no capital losses. But in real terms, you're losing a lot of money.

The interesting thing is what happens to equities. Now, that is more complicated and different from sector to sector. But here's the real concern. If we started yield curves, is a product of forcing savings institutions to buy government bonds, they have to sell something. And what they're going to have to sell is equities. Now that makes me... when we get to that stage and I will stress that we're not there yet. Could be once away, or we could even be a year or two away. We're not there yet. But when we get to that, I still think within the equity asset class, which is a huge asset class. There will be companies that do exceptionally well from this combination of high inflation and low interest rates that you can buy. But, the equity asset class as a whole would be under severe liquidation pressure from all those institutions that force lower interest rates, no so they're simply faster [inaudible] financial repression. It sounds like the easiest thing in the world. Also, I get it, the yield curve is low, inflation is high, buy equities. And so that sounds so simple, why wouldn't you buy equities if the growth rate is up, nominal growth rate is up, the discount rate says by equities. But if the only way to keep that discount rate down, is to force savings institutions to liquidate equities. It's a lot more complicated for equities than people think. So I know we're not on that stage yet. But when it comes, you'll need to be very good at selecting equities. And I think there's a certain type that can do quite well. And I'd much rather own that type of equities to try and preserve the purchasing power of my capital, then definitely touch the bond market. And of course, it looks good when we get to that stage.

***Erik:*** Russell, let's talk about how this inflation cycle is likely to play out because a lot of people you mentioned inflation to them, and what they think is oh, inflation, bad for the stock market like the 1970s. And you know, clearly we don't have that situation here. So what's your problem? I would say that the actual lesson if you study your history, and you're certainly the greater financial historian here is that the way inflation is almost always go down. Is they're really good for the stock market. That's asset inflation in the beginning, and then something changes and they get to really bad for the stock market. What's the something that changes? What actually is it that happens where inflation goes from good for asset prices to bad for asset prices? How can that be and how do we know when we're there?

***Russell:*** So I've done a study of this historically, certainly looking at America, post World War II. There is a nice guide for everybody and let me explain why the guide has worked, but then probably why it isn't going to work and what will work. When inflation is below and rising, and when a hits 4% is roughly when you should have been selling equities. So as you say, it's initially good for equities particularly recovering from a low level. Because you're coming from a lower level of deflation usually used to call it in my first book as usually very bad for equities but as it grows to 4%, actually equities go up. Interest rates may be going up as we go from 1% of inflation to 2% of inflation to 3% of inflation to 4% of inflation. But it doesn't matter! Equities go up. Why do they go up? Because the growth rate is rising faster than the discount rate. And the rise in the discount rate when you discount back future earnings is not impeding upon the growth rate. And therefore, you notice that if you have a gap between the gross rate and the discount rate, you get higher net present value in equities. So what happens at 4%? Well what happens at 4% is historically, that is where the central bankers are, oh, wait a minute, 4% inflation, that is dangerous. That is likely to trigger inflationary expectations and inflationary expectations as you know, the Fed has been for some time, I've been absolutely fixated with inflation expectations, we need to do something. We need to do something. And what they need to do is to start to drive the discount rate to a level that brings down [inaudible] Because historically or in economic theory, that's how you control inflation. You put rates up to have an impact on demand, and they're bringing down demand or slowing demand then you have an impact on prices.

But that's negative for equities. That's when you get negative for equities. You've got a higher discount rate, causing a lower growth rate and historically, this is when the whole thing begins to fall apart. You can see the problem with our analysis. What we've been discussing and how you started this interview, we can live with this discount rate. So maybe equities go to infinity. Basically, that's what happens because the growth rate keeps going up i.e. inflation under the grip component of the growth of inflation, and the discount rate doesn't then why do equities not go to infinity. So back to my key point here and this is crucial, because the markets looking for a deflationary bust to end this as we saw in 2007-2008, where it's looking at the traditional, too much inflation, rising interest rates. And my call is it isn't over. What ends this is a level of inflation that forces the central bankers to start expanding their balance sheets, and then forces them to get the savings institutions to buy bonds and liquidate equity. So it's a very peculiar end to the equity bull market. Because it's forced by something which is an unknown market force. Deflation, not corporate cash flow, market force, inflation, necessarily higher market rates, market force. I'm saying that nope, we don't get that this time. What we get is this administrative intervention to keep interest rates down forces a prolonged liquidation of the equity market. So that's a pretty extreme forecast because, you know, it doesn't usually happen that way and it hasn't happened that way since 1940. But anyway, that's what I think is going to happen and that's how this equity bull market comes to an end. And that's what I'm writing for my clients. It is what I call phase one financial repression, interest that's held all by central bankers to phase two interest rates held low by forcing savings institutions to buy bonds.

***Erik:*** Russell, when you talk about stage two financial repression, now that's an action of central banks, central bankers act on their own local currencies. That means that we can expect

this phase two of financial repression to appear at different times at different places around the world. So what do you expect is this something that happens first in the US, or it happens last in the US. Does the rest of the world follows? How does that work?

***Russell:*** Yeah, so this is absolutely the crucial thing, because the first rule of a financial repression for a receiver is to get your money out of the country. I mean, it's really categorically simple. Because the government is using your savings to achieve political goals. You might say, well, my savings are fine. But if you're in any form of regulated financial institution whatsoever, that's what's going on. So to the extent that you can get your money out and get it out of the country, so in other words, the exchange rate goes down. So when we move to that form of repression, there's no [inaudible] amount, so your exchange rate is going to do down. Unless if it was like Bretton Woods where we all sat in a lovely Hotel in New Hampshire, and everybody did the same thing at the same time, then no one's exchange rate maybe could go down, because we had all done it at the same time. There would be this new sort of global monetary system because of financial repression. But that isn't where the world is today for sure. The prospect of us all sitting down and agreeing in Germany, France, United Kingdom, China, Japan, and America that we all do this at the same time is highly unlikely. And highly unlikely because it's deeply political. We're talking about a big decision by an individual country, government central banks to move wealth within society. The idea that we all come to the same conclusion at the same time is very unlikely.

How do we work more guided, who goes first? Remember, the key implication of going first is a lower exchange rate. We go back to something I mentioned earlier, which is the private sector debt service ratios. We'll look at those and why do we look at those. Here are the people who can live with somewhat higher interest rates, but here are the people who are already seeing some of their private sector cash flow going to service debt that rates go up even a little bit. There's going to be a private sector debt crisis. And what we began is we can't live with rates that could bring about a private sector debt crisis. So the answer to that question for me is China and Europe. China and Europe have got much higher private sector debt service ratios in the United States. Some numbers on that. Interesting number is that, when America ran into its last major debt crisis at the end of 2007, we were looking at a private sector debt service ratio, about at 8 and a half percent, and it was 8.5 percent of all private sector cash flows were going to service debt. And that was enough, given the rise in interest rates we've seen prior to 2007 for something to crack. For someone to struggle to pay back interest and create a default in the private sector debt market, in the banking system, and create lots of problems.

When America stays at 13.5%, it's come crashing down, interest rates are down. But more importantly, the household sector in particular is devalued. The corporate sector hasn't. So it's more robust, and interest rates can go up. But France and China are just over 20%. More historically, that is exactly the level where you've had issues. When interest rates have risen, issues we go back through the three periods that are covered by the database. 1998 in Asia. 2007 obviously in America. 2011-12 in the European sovereign debt crisis. Any countries that have a private sector debt service ratio up towards 20%. if interest rates go up, they find themselves in a crisis. So those are the countries that have to repress first, because most of the

countries really were... they just can't permit market-determined interest rates. So it's a bit of a toss up at the minute as to who goes first, is it China, or Europe.

But the bottom line is the dollar goes up. I've long been a fan of the dollar. And that is a very non consensus opinion. Hasn't actually been a correct opinion but this is incredibly bullish for the United States dollar. I think Americans may be certainly pessimistic about the long term outlook for property rights in America. And you certainly won't hear me saying that America can avoid financial repression because it can't in the long run. But it's the last to go. Interest rates can go up somewhat and that's when we see the real shock. We see a tightening, not dramatic tightening, but we see some moves by the Central Bank of America, and deadly silence in Japan, China, and Europe. And then people begin to realize that a financial repression is coming somewhere else before it comes to America. And remember, the crucial thing about this is most people will tell you that currencies are real effective exchange rates, the interest rate differentials, and that's what [inaudible] interest rates, and for a long time it was true.

But sometimes you reach regime change. And that's what we're talking about. We're talking about a regime change and whenever a regime change comes first then somewhere else. You wouldn't want a regime change. A regime change in interest rates of private sector property rights, through the regulation of financial institutions. So people will flee to where that isn't happening. Now it may get to America eventually. As long as market gets lots of capital inflow, I would make a case for some emerging markets as well, which would probably benefit from capital exodus from countries like China and the European Union. So the sequencing is important. I think America is at the end of the chain, and therefore it's very positive for the United States dollar.

***Erik:*** Let's come back to something you said a couple of minutes ago about the scenario in which as interest rates are repressed, that we get to essentially equities inflating indefinitely. So many people are convinced that we've had this monetary experiment since 2009. That it's, you know, just going crazy it seems. Surely, it all has to end badly someday and a big stock market crash is coming. What if it's the other way? What if the way that this all ends badly, and I would describe it as an inflationary Great Depression. Where you have a situation where basically they have to inflate that debt away. They can't control interest rate. There's no way to keep them down and you have this runaway inflation where asset prices are through the roof in nominal terms. And you almost have equities serving the role the US dollar usually rolls during the process of dollarization in a hyperinflation of a smaller currency system. But in this case, what you've got is the people in the United States are moving more and more out of cash into equities, just as an inflation hedge. Is that a realistic scenario that could happen?

***Russell:*** Yeah so, I think that isn't a realistic scenario and the one bit of that, I can follow the logic for that, and then one where I disagree, and that is they lose control of interest rates. So you know, I can see exactly why you're [inaudible] on the market economy. Because in a market economy, of course, you can lose control of long term rates. That's our money. We want to demand 15% interest rates, because we think inflation is going to be 12% then we would do that. But, I can't see how they would lose control of interest rates because they control the

savings system. Now if I'm wrong on that, then we can definitely get to your scenario. So just to be clear, I don't think equities get to an infinitely high number because the nominal growth rate keeps going up and discount rates don't go up. I think that's what we've been living in really since 2009. That's why we are where we are and it can go further for sure.

But in some things, you can't keep using a central bank balance sheet to do this. So the only way that this can be extended is because you're forcing savings institutions to sell equities to buy bonds. Now, if for some reason, the central bankers or the government said no, that interest rates reflect inflation, well then I would be wrong. And there's more chance that things go in a very different way. But I think they can control interest rates. That's the difference. So I don't think this ends by rapidly spiking interest rates. They would let incredibly high levels of inflation, rather than spiking interest rates. That's where I think we're going. But it's probably for the worst possible reason. It's because the government steps in to control these variables, not because they're not the right variables to have in the market, it's because the government controls the variables. not slide your economy along the continuum from market economy towards command economy. But that's what financial repression is. That's what it is. Red in tooth and claw, and that's what we have to expect. So nearly everybody, including me. I've been in the markets for over 30 years. What have I seen? I've seen a world of more markets than US government. It used to be 10 years ago, and I have to accept that the next 30 years is more government and less market. And if I keep saying two years at the market price will be X. That isn't what we have to finish anymore. We have to say, the government will like price X, and what will it do at price X? Using an entertaining bit for the whole puzzle is what are th unintended consequences of price X. And that is the history of intervening in prices. They are unintended consequences. So that's why I don't think we get to the scenario you just outlined, but maybe they do lose control of interest rates, I think it's very unlikely given the social-political consequences of losing control.

***Erik:*** Russell in this game, sometimes we get our calls right and sometimes we get them wrong. But something I find really interesting is I think the guys that are long gold all made the right call for the right reasons and what we're seeing is the inflation is happening exactly as we predicted. But guess what's not happening? Price of gold. What's going on? Is this just about cryptocurrency stepping into to crowd out interest in gold or what's happened?

***Russell:*** Yeah, crypto is a little bit of it but it's certainly not all of it. Just on crypto by the way, whatever you think about market forces for crypto. Everything we've discussed, tells you one thing. if the government is to achieve what it seeks to achieve through financial repression, it cannot allow the supply of money to be dictated by the private sector. And that's ultimately what the dream of crypto is. A private sector currency and it isn't gonna happen. And China may have been the first to act but there will be others. So in terms of gold standing in the shadow of crypto, that will not last forever, because something will have to be done about crypto. If it ever begins to fulfill its function, which is as a currency, then governments can live with it as a speculative asset class the way they live with baseball cards as a speculative asset class. But they can never live with it as a currency because it takes so much power away from them. That will fall away from from gold and I call this from little bit of rising interest rates. And much of that

was huge rotation into gold back in early 2020, which has come out and people rushed out of equities, and they've gone back into equities, and they've come out of gold.

But the bottom line for gold is it is a play on negative real interest rates. And the very definition of financial repression is negative real interest rates. I challenge anybody to work on how we get rid of all this debt in the system without negative real interest rates. That's at least for gold. There's another interesting thing with gold that's come along. The politicization of credit, we haven't really had time to talk about but it's inherent in all the articles that I've read. Politicization of credit is evident and there are certain things that people will not be allowed to fund. Not that you have to pay more interest, but just you won't be able to get credit to fund those. And gold mining is potentially one of them. So I realize that many people listening to this own gold miners as well. But in terms of the green agenda, if you had to list all the things that we're expending all this energy for things that are legitimate to expend energy for. I mean keeping ICU units open with energy, nobody doubts that that is a legitimate thing to keep energy for. But keeping Bitcoin miners going and keeping gold miners going is something else and that is incredibly bullish for the price of gold. If the price of capital for all sorts of things that are now considered to be ungreen goes up, then the price of gold is already above granulation. So already, you're fine because most of its refined below ground and that is incredibly bullish.

And then financial repression means you're interfering with capital. And they may get to gold eventually. But I think, you know, people look back to '33, they look back to the Roosevelt edict on gold ownership, and they say, you know, this is going to come and maybe it comes eventually. But you got to remember back in '33,Gold was a big part of the allocation. I mean, gold was money and money was gold. The dollar was pegged to gold, and people owned a lot of it. So if you wanted to financially repress, you have to go after gold. Unlike what you might get there. But you look at the pile of paper assets. You look at the wealth that you can redirect from equities and bonds from private equity into government bonds and that's what you want to do. Well, maybe you get to gold eventually. It's still in the market but it's one of the bottom of the list. So that is a re-encapsulation of the history of gold. I mean maybe fundamentally everything is new there is this new green agenda. I think we should have worked out what it might mean for the production of gold.

**Erik:**
Russell, you're describing gold as a pure play on real interest rates. As interest rates adjusted for inflation. But Russell, real interest rates have been dropping like a rock, and they're really low now and gold's kind of where it's been. So how do we interpret that? Does it mean something's changed and the balances different or does it just mean, this is an inefficiency in the market, and right now gold is undervalued, and we ought to be buying it?

***Russell:*** Yeah, I just think it means it's the right I mean, it's an extreme example, but if you go to '45 to '71, the gold price didn't go anywhere. We had negative real rates.

***Erik:*** Well it was pegged during that time.

***Russell:*** Because it was pegged during that time. But it's a prolonged period of time where the gold price didn't... I mean it can take a long time for the gold price to work it out. That's all I would say, because there's so many financial assets in the world and there are other ways you can plan it. You can buy TIPS, you can buy bitcoin, you can buy other things. So there are other financial assets that perhaps that people go to first. I just think gold can be the one to catch up. And it certainly is taking a while to catch up, but it will catch up. We began this by discussing the risk of an overhang from China, deflation risk from China, that has affected all commodity prices. We're not just talking something in the last six weeks, really, the last six weeks, has had a pretty negative effect on gold. I spend my life talking to professional investors. And obviously, I've been talking to them about gold for some time, and they don't own it, they don't have the size, they don't have it in scale. Because they think it's not the sort of thing they can have in their portfolio, they prefer large liquid securities and that's where they tend to go typically into equities. Not changes in financial repression, because you're not allowed to. So it's kind of saying that people are trying to play inflation through pieces of paper. More pieces of paper available to do that than where we've had in history. But eventually, as you realize that those pieces of paper are being manipulated, you have more and more to go.

***Erik:*** Well, Russell, I can't thank you enough for a terrific interview. But before I let you go, I got one more question, which is, you really made some waves back in 2016 with your book "Anatomy of the Bear". All of a sudden, we got a new one. It's called "The Asian Financial Crisis from 95 to 98: Birth of the Age of Debt" available now on Amazon in book form and soon to be available for those of us who prefer audio book form. Why a new book now at this point in your career? What's the occasion? What's the book about? What can people expect to find when they read it?

***Russell:*** Well, it is a bit of an occasion because it's been 25 years since I started writing. So that was an occasion to revisit something. But the reason for revisiting that particular episode, like my first book, is that I have written contemporary new opinion. I had attempted then to forecast the future. And this is the crucial difference between my books and history books. History books look back of a bit of hindsight and so this is what happened. I'm looking at what people thought were gonna happen and didn't, which historians don't pick that up and look at events. But when you're in our business, you're constantly looking at the future. So I thought it'd be good to go back and look at how we got that so wrong. Not only did we get the fact that there wasn't a bit of a crisis, and there was, but also why people were still selling at the bottom.

So I did that but behind that is a much, much bigger story. And that is how we set the foundations for the age of debt, by aligning Asia and other emerging markets to undervalue their exchange rates. And at point, there was some mechanism of that that created the age of debt. And actually more important than all of that. That was the beginning of this great conflict between a form of capitalism which comes from the United States and a form of capitalism that comes from North Asia. And in North Asia, is what I would call more of a social capitalism. In those days it was Japan and it was Korea but now we add China into that. And we're still living with that battle between these two on a nightly hit when I lived in Asia. People were convinced that the western form, the American form had prevailed and it didn't. There was a form of trust

and it seems to me that what's happening is we're becoming more North Asian. That's what financial repression is all about.

So there's a modern networking and is kind of all these different levels. And the other thing that I'm really excited about is after 16 years of running a course on financial history, we're finally putting it online. So that's basically a free online video version of that course to teach people the lessons from financial history as well. And they can find out about that. If you put my name and course into the Google, you will come to the pages and find out. Just send me an email, you will find my email address there. And I will tell you about my course. It is not quite ready for launch yet, but within a month, we will be able to offer that. I think it's 1500 professional investors have taken it from anybody anywhere in the world. So after a long, hard slog this year to get that ready. So that's two big projects I've finally finished off. It's been a tough year. But COVID allowed me to do these things. I see a solid reason for this. Now, I've had the time because of COVID to do some of these things that I've long wanted to do.

***Erik:*** Well I have not seen that class yet, but I can't wait to see it online. I know my co-0host Patrick Ceresna actually took that class in Toronto and spoke extremely highly of it and quite enjoyed meeting you as well. So we look forward to getting you back on the show for an update in a few months. Meanwhile, Patrick Ceresna and I will be back as MacroVoices continues right after this message from our sponsor.