# “Yield Curve Control, the Biggest Mistake of the ECB So Far!” – Exclusive Interview with Russell Napier

***“Everything has changed on a permanent basis. I don’t believe that inflation goes up and comes back down again, because these are permanent changes in the very structure of how the system works.”***

**Russell Napier**

**Key Takeaways**

- Governments have effectively taken control of the commercial banking system. The commercial banking system will increasingly lend on demand to what the government wants it to lend to.
- Broad money growth will be much higher than it has been in the age of disinflation with deflationary episodes.
- Inflation will be global. Every developed world market has seen very high levels of broad money growth, without exception.
- The first rule of repression is “get your money out of the country”.
- The European Central Bank’s decision to introduce Yield curve control will go down in history as one of Europe’s greatest mistakes.

**Professor Russell Napier is author of *The Solid Ground* investment report for institutional investors and co-founder of the investment research portal ERIC, a business he now co-owns with D.C. Thomson. Russell has worked in the investment business for over 30 years and has been advising global institutional investors on asset allocation since 1995.** Russell is author of the book *Anatomy of The Bear: Lessons From Wall Street's Four Great Bottoms* ('a cult classic' according to the FT) and is founder and course director of *The Practical History of Financial Markets* at The Edinburgh Business School.

Ronnie Stöferle and Nikolaus Jilch conducted this interview by Zoom on March 11, 2021.[1,2]

Source: Youtube

**Ronnie Stöferle (RS):** It is a great, great pleasure to have Russell Napier here. Thank you very much, Russell, for taking the time. You're indeed one of my very favorite strategists. Everything that you write, I have to read; every podcast that you do, I have to listen to. Thanks for taking the time. It's a great pleasure.

**Russell Napier (RN):** Thanks Ronnie, delighted to be here.

**RS:** And also, my dear friend Nikolaus Jilch is here. Nikolaus is a researcher at Agenda Austria, a free-market think tank based in Vienna, and also a long-term contributor to the *In Gold We Trust* report. Hi, Niko!

**Nikolaus Jilch (NJ):** Hello. Nice to be here. Thank you for having me.

**RS:** Niko, many, many years ago you interviewed me when I was still working at the bank, and you wanted to write a very critical article about gold, and then I mentioned this *Austrian School of Economics* and we talked about monetary history and...

**NJ:** It's all your fault!

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[1] The video of the entire interview "Yield curve control, the biggest mistake of the ECB so far!"can be found on YouTube at https://www.youtube.com/watch?v=PmlORdi-8bU.
[2] A short version of this interview is part of the *In Gold We Trust* report 2021, *see* https://ingoldwetrust.report/download/12773/?lang=en.

**RS:** Sorry about that! You swallowed the red pill!
Let me do a brief introduction of Russell.

Professor Russell Napier is the author of *The Solid Ground* investment report for institutional investors and co-founder of the investment research portal ERIC, a business he now co-owns with D.C. Thomson. Russell has worked in the investment business for over 30 years and has been advising global institutional investors on asset allocation since 1995.

He's the author of the book *Anatomy of the Bear: Lessons from Wall Street's Four Great Bottoms*. (A fantastic book, thanks again!) And he's the founder and course director of the *A Practical History of Financial Markets* course, a course that I will probably attend very soon; and everybody who has attended says it's something that everybody interested in financial markets really has to do.

Russell has degrees in law from Queen's University, Belfast, and Magdalene College, Cambridge. He's a fellow of the CFA Society of the UK and is an honorary professor at both Heriot-Watt University and the University of Stirling. He also writes a regular column for the *Toronto Star* newspaper. And his second book, which covers the events of the Asian financial crisis and the lessons to be learned from it, will be published in summer 2021.

So, Russell, again, thanks for taking the time!

*You have been a deflationist for decades, and you changed your point of view in the last couple of months.*

We will talk about topics that we've got in mind at the moment. I told you before that, actually, it seems that we're not alone anymore in the inflation camp. We will talk about financial repression; we will talk, of course, a bit about gold. And yeah, I would say, let's just jump in. Niko, do you want to start?

**NJ:** Yes, thank you. The main topic – not just for this talk, but I guess for the whole year – is the question of inflation. You [Russell] have been a deflationist for decades, and you changed your point of view in the last couple of months. Could you walk us through your thinking? Because I think that's the main point of our discussion.

I was told by various academics that it was impossible to have deflation. It was impossible to have deflation because central bankers would always be able to beat it. And we've had it anyway (admittedly briefly).

**RN:** Yeah, I think decades is right! Actually, I've got… just over to my right here, I've got framed a report I wrote in 1998, called "Dealing with the 'D word'", and the "D word" was *deflation*. That was 22 years ago. And, basically, in any economic contraction we've had since 1998, the "D word" has come up, including in the most recent episode; but it's now come up several times.

You've got to remember that this is exceptional, because **my entire career before that had to do with inflation**. And really, between 1958 until 1998, there were no brushes with deflation whatsoever, and I was told by various academics that it was impossible to have deflation. And I say that with a straight face! It was impossible to have deflation because central bankers would always be able to beat it. And we've had it anyway (admittedly briefly).

So after all this time, **why on earth have I changed my mind on inflation**, which I did last March or April? Crucially, it is because of a change in the structure of finance. So it's nothing to do with a change in the business cycle, or the levels of stimulus, or any of that. **It is to do with who creates money, how much money they create, and whose hands that money is in.**

*Why on earth have I changed my mind on inflation? It is to do with who creates money, how much money they create, and whose hands that money is in.*

So for me, the crucial structural change here is that the governments are providing credit guarantees to the commercial banking system. In the era of quantitative easing, commercial bank credit growth was very low. What everybody who's watching this needs to know is that most money in the world is created by commercial banks, and they really didn't lend. **Interest rates were too low; regulations were too high; people didn't want to borrow; and, basically, the commercial banking system just simply couldn't expand and create money.** And then we offered the credit guarantees from the government. And now we have, across the world, **bank credit growing really strongly in a recession, which is absolutely unheard of.**

If we follow the example of the British government, for instance, in the budget of last week, they have now announced **credit guarantees on mortgages**. That's got nothing to do with an emergency COVID-19 response. In my opinion this is the "new normal".

*And now we have, across the world, bank credit growing really strongly in a recession, which is absolutely unheard of.*

The governments have effectively, through the powers of regulation, taken control of the commercial banking system. The commercial banking system will lend on demand, effectively, to what the government wants it to lend to. Therefore, broad money growth will be much higher than it has been in the age of disinflation, with deflationary episodes. And it's that structural change that really confirms the likelihood of high money growth and higher inflation, for a very prolonged period of time. So something changed structurally. And that's why I changed my mind.

**NJ:** The main storyline right now is that we will see a brief pickup of inflation, and then see it go away again. Is that not what you believe?

**RN:** No, it really does depend. There's one way I could buy into that. I could buy into that if what we witness is a pulse of bank credit going out in the emergency; and then it stops and bank credit rolls over, and with it money supply growth rolls over. But the authorities have learned their lesson from the last time, and they aren't going to let that happen. And **whatever it takes to get the banks to extend credit will be done**. I look at the mandate, the change in remit that the Chancellor of the Exchequer handed to the Bank of England last week. The Bank of England has to support the Long-Term Asset Fund, the housing market, the "levelling up" agenda, the green agenda.

*Whatever it takes to get the banks to extend credit will be done*

Now, when you give a central bank… and the central bank has a role to play in commercial banking… when you give it all these political targets, they are not compatible with the inflation target. **So it's not just that we've changed the mechanism through which commercial banks lend, we've changed the policy target of the central banks.** And it would be virtually impossible today, given the target and the remit, to say that inflation is still the dominant target for them.

So everything has changed on a permanent basis. So **I don't believe that inflation goes up and comes back down again, because these are permanent changes in the very structure of how the system works.** And I'm sure we'll come on to talk about yield curve control. But that is another one. You know, that's the third one that we're running into. Structural changes, not cyclical changes. Therefore, structural changes are sustainable, and you don't get a cyclical uptick in inflation, you get a structural uptick in inflation.

*Everything has changed on a permanent basis.*

**RS:** So I think those credit guarantees… that's really a topic that you were basically the first to talk about, and the reasoning for this shift from a deflationary (or disinflationary) environment to an inflationary environment.

But Russell, what would you say about those additional topics like, you know, MMT? It used to be something for left-wing economists sitting in their ivory towers. Now, it is really something that is going mainstream. Topics like average inflation targeting, topics like the demographic change. Then, of course, I think it is really fascinating to follow the exchange value of the US dollar versus the renminbi. **We saw enormous strength in the renminbi since the end of May, which also, from my point of view, is some sort of inflationary driver.** So, you know, those other topics, do you think they just add to your main case, or should we analyze them separately?

**RN:** No, I think they add to the main case. What I think is really interesting about all of those that you mentioned is they're all structural. Again, this is the crucial thing.

You know, you can sometimes go a whole career and just be guessing the business cycle. And that's a game you can play, and you can play it profitably. And then sometimes you have to live through a structural change. As you say, the legitimization of MMT, the politicization of central banks, credit guarantees… I mean, **it just comes in an absolute flood**. And this is clearly a very big structural change. And when you get one of those, **most people are entirely unprepared for what happens next**. Because, remember, people who are successful in our business, have been people who have played a disinflationary trend for 40 years. And they've played a system which was a market-oriented system, and not an inflationary, less market-oriented system; and the skill set for that probably needs to be entirely different. **What very rarely happens is that the revolution of the mind catches up with the revolution in money-making.**

*This is clearly a very big structural change. And when you get one of those, most people are entirely unprepared for what happens next.*

Most people in the markets are stuck in that. Now, you might say, "Well, I'm one of them, because it's been my career as well", but one of the advantages, perhaps, I have is an understanding of financial history; and I think this period we're moving into and all of the things you've mentioned here, is like the 1945 to 1978 setting.

So we can go back into that period and look at the consequences for investors of these sorts of policies. There's now a very different structure of a market from before, but what I thought was particularly interesting about everything you said there is it represents a change in the zeitgeist. **Savers have done too well; debtors are overburdened; money has to be moved from one to the**

**other; and there's very little in the political circles or central banking circles that will push back against that.**

The zeitgeist is simple: **It's the savers who've got all the money.** The money has to come from the savers. Now, you can do it directly through taxation, or you can do it through that other form of taxation known as inflation.

*The zeitgeist is simple: It's the savers who've got all the money. The money has to come from the savers.*

So the zeitgeist has changed. That's why the structure changed, and everything you mention is good evidence of that.

**NJ:** So are you basically saying we're going to see a replay of the 1920s, where first everything feels good, everybody thinks they're getting richer, but they aren't?

**RN:** I don't think it'll be along those lines, or it depends where you are in the 1920s! Obviously, it matters whether you were in Germany or in America in the 1920s. I mean, that's a good example, isn't it? America had deflation, price stability… but actually in many goods it had deflation… and Germany had hyperinflation. What was the difference between the two? It was primarily the rate of money supply growth.

There were massive technological breakthroughs after World War 1 in terms of electrification, the internal combustion engine; **all of these things were desperately, desperately deflationary**. The death of the horse was very deflationary; it freed up lots of agricultural land, which went into production of food for people. But if you lived in Germany, or Austria, in that time, monetary policy was able to more than offset this.

I think it highly unlikely that we go to hyperinflation in this setup; **I think it's likely we go to reasonable levels of inflation**. But the crucial thing is that interest rates wouldn't be allowed to reset to reflect that inflation. I think that's the most important thing for savers.

So, depending on which 1920s you think we're in… I don't think it's the German or Austrian or Hungarian 1920s. Nor do I think it's the American 1920s, because we're going to suspend the free market in government debt; and that, ultimately, will be the most important thing for investors during this period.

**NJ:** So, basically, you're saying that the inflation will be global?

*If the developed world creates that much money and inflation, it is really very difficult for the emerging markets to remain immune to higher inflation.*

**RN:** Yes, I think inflation will be global. I mean, every developed-world market has got really high levels of broad money growth, without exception. And when I say "really high", I mean triple the rates of a year and a half ago; and if we aggregate them, **we're looking at the fastest growth in broad money globally since 1988**. And if we go all the way back to 1980, there would have been six months when it was growing faster than this. So it's very clearly a global phenomenon in the developed world, but not necessarily in the emerging world. But the point is, if the developed world creates that much money and inflation, **it is really very difficult for the emerging markets to remain immune to higher inflation**.

**NJ:** But you did mention the technical breakthroughs 100 years ago after World War 1. And there is no shortage of technical breakthroughs now. There is technology, and technology is still deflationary. Will that have an effect?
**RN:** Well, that's kind of why I mentioned Germany in 1923, because Germany also benefitted from massive technological breakthroughs; but somehow, just by the power of the printing press, they negated those. **I would say the real acceleration and deflationary forces began in 1995.** And the world begins to change in 1995. Interestingly, that's when US equity valuations seem to move to a permanently higher level.

*I would say the real acceleration and deflationary forces began in 1995.*

Two things happened in 1995. **China had devalued its exchange rate in 1994**, and it was now selling at much cheaper prices and, obviously, mobilizing hundreds of millions of people to get productive. And also, **Jeff Bezos sold his first book in 1995**. So where is the birth of the technological revolution? Well, you know, it's always been with us, but maybe it accelerates in 1995.

I looked this up last night. What has happened to the price level in America since 1995? It's risen 75%. I think we all recognize the scale of the deflationary forces that have been ripping through the world since 1995. And yet **prices are 75% higher, based on the CPI, than they were in 1995.** Now, that's actually not a lot over all of that period. But it's still a 75% increase.

So somehow, in the teeth of the biggest technological acceleration the world has ever seen, and in the teeth of the biggest mobilization of underutilized labor the world has ever seen (certainly, at least, since we opened up America)… **in the teeth of both those things, we push prices up 75%.** So there's something else going on in the world of prices, rather than just technology, and just China. So it can be done. It has been done. And it will be done again.

**RS:** Russell, you worked in Asia for many, many years at CLSA. And I think when we had a chat you said that another driver for our inflation topic would be a proper cold war between China and the US. I think this is perfectly playing out. It seems that it is not getting better now with Joe Biden sitting in the White House. How strong is this effect of China becoming more and more of a real competitor to the US when it comes to technological things? Military? And of course, especially the economy?

**RN:** Yeah, I think it's very powerful. I mean, the last question was about technology, and I brought China into it because I think it's been both that have given us this prolonged period of inflation and deflation.

*The Biden administration, whether it builds a coalition or not, has a much better prospect of building a coalition to contain China.*

What Trump could do was attack China, but what he couldn't do was to contain China. You need a coalition. And that coalition has to include Europe. And Trump was unable to build coalitions, even with his wife, I think we could say safely! I mean, he's not very good at building coalitions.

The Biden administration, whether it builds a coalition or not, **has a much better prospect of building a coalition to contain China**. And that containment must be about containing its external accounts, containing its ability to export.

**I don't see any move back from this cold war that we're going into.** And I really… obviously, as a citizen of the world, I hope that's wrong and that we don't. But that was massively deflationary. I mean, I looked just a few weeks ago, and I think it's true to say that the price of Chinese exports hasn't really changed in nearly 30 years. It's astounding, I mean, look back at a period of history; you basically have to go back to the gold standard to find a period where a major exporting country didn't get any rise in prices. And you can look at the price of Japanese exports, or Taiwanese exports or Korean exports, and you tend to get the same thing. And that was all to do with China. So I don't have any doubt that as we contain China, and that will focus on its exports as well, **the major deflationary force that was China will begin to move into the background**. And that's even true if they have to let their currency float (which I think they probably will). It would initially go down, but it would just attract even more tariffs, and even more protectionism of China if the Chinese exchange rate went down.

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**So this cold war is very, very inflationary**, not just because we seal off that production, but it starts an investment boom, on an unparalleled scale, because the other side in the cold war has to begin to build all this capacity that China is not providing to the world anymore. So it is very inflationary. **I always begin with the proposition that inflation is everywhere, at all times, a monetary phenomenon**; but I'm very happy to discuss real effects as well. And this China ostracization is clearly one of these real effects.

**RS:** Isn't it a bit ironic that now the People's Bank of China is running some sort of a conservative monetary policy, and you kind of get positive real yields there? I hear from many investors nowadays that they're really considering buying into the Chinese bond market. And it seems (I've read a couple of reports about this) that they now seem to be letting companies go bust, so it seems that to some degree, they're even a bit more market-oriented than we are in the Western world.

*This cold war is very, very inflationary.*

**RN: I think it's one of the biggest wealth traps ever, buying Chinese government bonds.** There are two reasons for that. One is that, in a cold war it would be illegal (just to point that out). I mean, lending money to the Chinese government to build aircraft carriers would not be legal in a cold war. And of course, that's slightly hypocritical, given how much money the government of China lends to America to build aircraft carriers.

*I think it's one of the biggest wealth traps ever, buying Chinese government bonds.*

But hypocrisy has got nothing to do with geopolitics. So it could be a situation where you're simply not allowed to do that.

I mean, we get people protesting all the time. Now, why wouldn't I stand outside of a fund manager's office and protest if he held Chinese government bonds, given that the money is directly financing the suppression of the Uighurs? You know, I just think it's going to become a very difficult position to maintain that "I fund the Chinese government"; and, as I say, it's hypocritical, but it's there, and it's going to become an issue.

But there's a much bigger issue as to why I think it's a wealth trap to put money into Chinese government bonds**. China's debt-to-GDP ratio was just as bad as America's.** It isn't this wonderfully ungeared economy. It used to be before the

GFC. But it had, **prior to the COVID-19 crisis, the fastest-rising debt-to-GDP ratio ever seen in history in a major economy.** If we look at its debt-service ratio, which takes into account interest rates, as the debt-service ratio of the private sector, it's got one of the highest in the world.

*China's debt-to-GDP ratio was just as bad as America's.*

I'm not singling China out. The entire developed world has to inflate away its debts, and the only emerging market that has to do the same as China. You don't want to own bonds in a country that has to inflate away its debts. Now, it's currently constrained on that, because it's managing the exchange rate, and that does constrain how much money you can create. And Chinese broad money growth is only at 10.1%, slightly above Japan, below Europe, half of America but they'll have to change that. They're currently in a debt trap, and to get out of the debt trap, they will also have to inflate away their debt. So to buy government bonds, you clearly don't believe that the government will ever come and inflate away your debts. But it seems as likely in China as it is in Europe as it is in the United Kingdom, as it is in the United States. So **I strongly, strongly recommend people not to invest in Chinese government bonds.**

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**NJ:** When you talk about inflating away the debt globally, what does this look like? What does this mean for financial markets and for the everyday lives of people?

**RN:** So, this will surprise you to hear that actually, **for everyday people, it's pretty good. For savers, it isn't.** So let me explain.

There are two things you have to do to pull this off: You have to create a high level of inflation and a low level of interest rates simultaneously. And anybody who's watching this, who has been to business school, will tell you that's impossible. Because in a free market we would all demand a very high level of nominal rates to compensate us for existing inflation and expected inflation. So **the only way you can actually pull that off is to suspend the free market in interest rates.** And, I would argue strongly, that's what the European Central Bank has announced today. It has said in roundabout terms that it's going to be capping the yield curve.

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There was a speech, a more accurate speech, by Fabio Panetta of the ECB board last week saying "No, no, it's even better than that we're going to anchor nominal yields, and we're going to drive inflation above that." **That's exactly how you would inflate away debt.**

Just let me give you some historical examples. By the end of World War 2, both France and the United Kingdom had very similar levels of government debt to GDP at about 280%. By 1980, the United Kingdom took it from 280% to 50% of GDP. And it has done that by, pretty constantly, **keeping inflation slightly higher than interest rates.** But it took a long time because there wasn't a big gap, until the 1970s.

France achieved exactly the same thing in five years. And the way France achieved it in five years was that interest rates were about 5% while inflation was 50%. Now, in that environment you can wipe out your government debt very quickly, indeed. I don't think anybody will contemplate that I think the dislocation and destruction of wealth will be too great.

*It doesn't surprise me to know that the biggest advocate of inflating away debt is French; he's called Thomas Piketty.*

**So you take your pick; is it going to be the French approach or the British approach?** Either way, the only way you do it is to keep inflation above bond yields; and if it's just a small gap that goes on for decades, and if you're prepared to live with a very big gap that goes on for much shorter period of time.

It doesn't surprise me to know that **the biggest advocate of inflating away debt is French; he's called Thomas Piketty**. So I don't know if that's a coincidence or not. But France historically has been quicker to grasp the part and inflate away its debts. And it's fascinating, because it's given away that part (technically) to the European Central Bank. But the European Central Bank is of course run by an ex-French finance minister so this could come in useful.

**RS:** I think it's pretty interesting to see that non-economists are now the heading the ECB but also, of course, the Federal Reserve. And I think the symbolism of Janet Yellen now becoming the Treasury Secretary as a former Federal Reserve head, but also Mario Draghi, former head of the ECB, now becoming Prime Minister in Italy… I think this is a perfect picture and the perfect confirmation of this marriage of fiscal and monetary policy recently.

But Russell, what I wanted to ask you is, we haven't talked about the Austrian School of Economics so far…

We [Ronnie and Niko] are both from Austria, and we very much adhere to Austrian thought. I think you probably also have some sort of sympathy for Austrian ideas. But having a look at markets at the moment, we're seeing basically that everything is rising; we're seeing all-time highs in basically every asset class.

*Are we at the beginning of a crack-up boom?*

I just saw that NFTs, which seem to be the next big thing – "non-fungible tokens"… there was a picture (or a kind of a painting) that sold for, I don't know… $69 million, something like that? We're seeing in the equity markets stuff like the SPACs [special-purpose acquisition companies]; we're seeing developments where lots of retail money is coming into markets; we're seeing that commodities are now really surging.

Are you familiar with the idea of the "crack-up boom", from Ludwig von Mises? In German, the term is *Katastrophenhausse* which is really "a catastrophic boom". Would you say that we are at the beginning of this move, where people really lose confidence in paper money and just want to get as many real assets as they can get?

*I have great sympathy for the Austrian School, but – and it's a big "but" – I'm a Calvinist, you see, and therefore it strikes one as a moral code.*

**RN:** I have great sympathy for the Austrian School, but – and it's a big "but" – I'm a Calvinist, you see, and therefore it strikes one as a moral code. It strikes one as an incredibly moral thing that those who do things badly get punished. And those who do things well get rewarded. But I see absolutely zero evidence of that in the post-1929 setting.

*I know that central bankers will do everything in their power possible to stop the powers of Austrian economics.*

You've got to remember that what changes in 1929 is not the gold standard; what changes in 1929 is that we become a democracy. We don't have democracies until then, because women didn't have the vote. So when women get the vote, we become democracies, and **democracies cannot live with Austrian economics or the consequences of Austrian economics.**

I do realize we're going to start a big debate on that, and there'll be a bit of pushback on that. So I have never actually analyzed Austrian economics; and although I have sympathy for it, I've always looked at it from a monetary perspective, because **I know that central bankers will do everything in their power possible to stop the powers of Austrian economics**.

Now, I also would agree that, eventually, that just takes you to a huge catastrophe, if you constantly do that; but let's be clear (before I do the timing of this *katastrophenhausse),* let's be clear what it takes you to. **It doesn't take you to everything getting wiped out; it takes you to the government running everything.** That's what happens in a democracy: The government takes over. And it's not that everybody gets wiped out and there's some great Austrian clearing; it's quite the reverse. It's that even more market forces are suspended. And you go into something even more like a command economy than you had before.

So I realize that's a disagreement with the *Austrian School.* I'm afraid it just doesn't happen, because the political consequences are so great. So that's what I'm really concerned is happening everywhere, actually, but particularly in Europe at the moment, that **we're just slipping into this thing where the government and the central bank will control all the variables.** And it seems to me that is going to happen.

In terms of where we are in terms of "the money has no value and we'd better get out", there's actually quite a long way to go. There really is quite a long way to go on that.

*So in terms of real assets, we're probably in the early days.*

You know, I'm one of those people who speaks to the market every day. There's certainly no great belief from most people that inflation is getting out of control. **Even inflation at 4%, historically, doesn't send anybody rushing into real assets.** You know, we've had inflation at 4%, three times now in the last 30 years. And it didn't send people running into real assets; you really need a level of inflation much above that. I think we'll get there at some stage in this business cycle, but it's not imminent. So in terms of real assets, we're probably in the early days.

Now SPACs and tech stocks – those are not real assets, which are something entirely different. So that bubble may be at its peak, and I think these are incredibly difficult things to work out. But **the so-called "bubble in real assets", actually, I think it's just beginning rather than ending.** I think it has a long way to go.

Actually, I've got on my desk here a one-ounce silver coin from 1902, which is the last time the British government put one out. That's how long it's been since we lived in a world of real money. It's a long time since we've had it! And as long as we continue not to have it (and we won't have it), the value of real assets can go up a hell of a long way from here. So I think that's really only just begun. By the way, I prefer these two Pokémon cards, and Pokémon cards are going up even faster than one's pieces of silver!

**NJ:** It's not an ounce piece, but I do have an Austrian shilling coin from 1974. They were made out of silver until 1974 here, and now they get bought for their material value.

**RN:** Can I just interrupt? Because I have an Austrian one here as well, which you'll probably recognize. This will bore everybody, but this is a Maria Theresa thaler, which is a one-ounce silver coin. And you probably know that these are still made. There are lots of reasons why they're still made, but one of them is that they still circulate as currency in the Horn of Africa, where this is not only a store of value but a means of transaction. I was lucky enough to have lunch with Sir Bob Geldof a while ago, and I showed him one of these and he said, "Yeah, they are all over the Horn of Africa. I wonder why?" So this coin has maintained its value, even as a means of transaction, I think, since 1782. Not a bad record for a piece of silver!

*Why do central banks still own gold? What's the plan there? Do you think there is a plan?*

**NJ:** Can I pick you up on that? Because the Austrian Mint, where the silver piece and the gold Philharmonic are minted, is owned by the central bank. And the central bank is part of the euro system. The euro system has 12,000 tons of gold. So what do you think is the role of gold within the monetary system right now? Why do they own the gold? What's the plan there? Do you think there is a plan?

**RN:** No, I don't think there's any plan. I think it's a legacy of where reserves were historically infused. Some people, like the British, sold their gold, but most people just hold it as a legacy. I don't think there's a great deal of planning on this; **there certainly would be no plan to go back to a monetary standard or a gold standard. In a democracy that would only happen after a hyperinflation.** And that's the only way we're going back to the gold standard. Democracy, in my opinion, is incompatible with hard money.

*Democracy, in my opinion, is incompatible with hard money.*

**NJ:** But do you think there's a possibility that elements within the central banks realize that they need to open avenues for normal people to run away from inflation in some way?

**RN:** No, I think exactly the reverse! I think if you're going to inflate away debt, the most important thing is that there is nowhere for someone to hide, that there is no way to run away. And you certainly don't want to open an official channel. I mean, there are places to run away. There are countries that won't do financial repression; you can buy silver, you can buy gold; but the idea of opening an official channel to do it is somewhat unlikely. I mean, I buy gold from the British mint. So there's currently an avenue to do that. That may be restricted in terms of annual production, or something like that. But I think it's a great question, because it raises the issue of crypto and Bitcoin, which nearly everybody who's buying thinks is a way that you can escape financial repression. And the answer is, it can't be, because if it is then everybody will use it, and you can't do financial repression.

So a repression is really about closing all these loopholes and putting fish in a barrel. I mean, **if you want to shoot fish in a barrel, you had first better put them in the barrel first, not offer them an escape route**. So tightening up all these controls is really the first place you go as a government or as a central banker, rather than opening up more loopholes.

**RS:** I think you once said that financial repression is **"the art of stealing money from old people slowly".** We already have quite a lot of financial repression. As an asset manager, it is for us, in the UCITS fund it's basically impossible to hold physical gold, but it's perfectly fine to buy Portuguese debt at negative yields. But gold is obviously too risky in the eyes of regulators. However, don't you think that if we see financial repression really much more dramatic than we have now, wouldn't that have to go hand in hand with capital controls?

**RN:** The answer to that must be "yes". I always give you very long answers, really, but the answer to that must be "yes". We really haven't had a financial repression without capital controls.

So let me just lengthen the answer a little bit. It could be a different form of capital control. It might not be a capital control that stops you crossing the border with money in your pocket; it could be a different form. And the form is **that you just really so strictly regulate your financial institutions that people can't take any money out of the country.** Now, that may be sufficient, and it may be insufficient, but it's where you can start. And it is worth going back in history. You know, we take it for granted now that most wealth is held in regulated financial institutions. But **if you go back to the end of World War 2, most wealth was actually held in the name of individuals.** And therefore, to stop money going out of the country, you had to really tightly regulate even individuals. In a modern world, with so much money held in regulated financial institutions, it may be possible to do what are actually capital controls, just under the guise of macroprudential regulation. So if I lived in Germany, they would say, "Look, no institution can own gold, because it's too dangerous. No institution can own equities, because it's too dangerous." Now, that is a capital control, in my opinion; but it doesn't get called that, it gets called "macroprudential regulation". So the simple answer to your question is "yes", but it may come in a different form.

*This is the main problem I have with financial repression. It ultimately involves forcing savings institutions to buy government bonds.*

**NJ:** But, to understand correctly, do you not see the broad equity markets as a way to get away from financial repression?

**RN:** Yes, components of the equity market, yes, but this is the main problem I have with financial repression. **It ultimately involves forcing savings institutions to buy government bonds.** You really can't continue to do it using the central bank balance sheet, because you'd be creating too much money. And if I say to... let's pick a German fund... if I say "you must have 75% of your money in German government debt", well, they have to sell something. And I think what they sell is equities. It's one of the things they sell, it's not the only thing they sell.

*So that will be the first thing if we go to that form of repression, you've got this prolonged sale of equities.*

So that will be the first thing if we go to that form of repression, **you've got this prolonged sale of equities**. Having said that, the beautiful thing about equities is there's so many of them and so many different types of companies. And there are bound to be companies that will benefit from a high inflation, which means high selling prices, particularly if they have high fixed costs, such as depreciation or interest expense. So it would be impossible to dance in and out of the bond market to defend yourself from repression. It might be possible to take positions in the equity market to defend yourself from repression, even though equities generally would be going down. **The first rule of repression is "get your money out of the country".**

*The first rule of repression is "get your money out of the country".*

**RS:** We published this report about inflation called "The Boy Who Cried Wolf".[3] And, I think it's interesting, I had a look at the Bloomberg forecasts for inflation. The most important economists say for 2021 is that they forecast 2.3% for 2022, or 2.2%, and then it should fall slowly to below 2% again. This would be, let's say, the "feel good" area for equities. But at 2.5–3.0% (something in this area), this "feel good" zone ends and it ends quite abruptly. So I think it's important also to stress the point that equities, per definition, aren't the best inflation hedge. It really depends on the sector.

There's a great article by Warren Buffett: "How Inflation Swindles the Equity Investor".[4]

But Russell, if we see rising inflation – and you're not talking about hyperinflation, but I think something around four, five or six percent should be possible from your point of view – a large part of the equity markets won't do so well; bonds will have a hard time… so what's actually left? Besides real estate and perhaps gold?

**RN:** Yeah, I think we need to talk about that in a bit more detail. Normally, growth goes up, inflation goes up, interest rates go up, and equities go up. That's the normal situation.

When you look historically, recently inflation can get to 4% and equities just keep going up, even though bond yields are going up. That's the normal scenario. And obviously, you know, we're quite a long way from that. So that would suggest to just hold equities until we get near that level. But I think – and it's a very big "but" and the most important "but", and we've kind of already discussed it –would we ever allow the 10-year bond yield to reflect those levels of inflation? That's the important question.

So you pick a number – you just mentioned that some of these analysts are forecasting 3% inflation for two years – where would bond yields be at 3% inflation, even if you think it's going to roll back over to 2%? Surely you're going to be saying that euro bond yields should be at 3% or 4%? **Well, actually, they're going to be 0%. Because today the central bank just told us they're going to stay at zero.** I mean, they categorically said the yield curve is staying where it is: It ain't going anywhere! Now, that's different. That's not what we expect to happen.

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[3] *See* "The Boy Who Cried Wolf: Is an Inflationary Decade Ahead?", Incrementum AG, November 2020

[4] Buffett, Warren: "*How Inflation Swindles the Equity Investor*", Fortune, May 1977

So back to the previous question. What does that mean? Because this is completely different from anything we've ever seen before. And we've already discussed whether that's positive or negative.

*They categorically said the yield curve is staying where it is: It ain't going anywhere! Now, that's different.*

In terms of where you put your money, though, why don't we just find a country that hasn't or doesn't financially repress? After World War 2, that was Switzerland. For a very good reason, Switzerland ended World War 2 with not very much government debt, for reasons that everybody knows. It didn't have to inflate away its debt, and one of the simplest things you could have done as an investor in 1945 was put your money in Switzerland and go to the beach for 40 years. That was kind of all you really had to do. I think the emerging markets – and this is obviously contentious, given that we associate them historically with more risk – but the emerging markets, excluding China, have a debt-to-GDP ratio of 166%. The developed world is at 300%. France is at 371%. So I think emerging markets… and gold (which I know you would like to talk about); **gold is definitely somewhere to put money in a repression**.

*Gold is definitely somewhere to put money in a repression*

But if you get stuck inside a repression, **residential real estate is actually another place where you do quite well**. The price of the residential real estate may only rise in line with inflation, so you might think, "Well, I'm not actually protecting myself." But obviously, if you've borrowed heavily, and interest rates don't go up, then you benefit from that. So there are some places where you can cover yourself from this, but a lot of them will be outside the repression regime. If you get stuck inside a repression regime – and I'm using the word *stuck* because we mentioned the phrase *capital controls* – you've got to run very, very hard to stand still as a saver.

**RS:** But don't you think that investors and people running businesses are always one step ahead of government actions, and that they anticipate future financial repression and capital controls? I mean, that's already happening, probably.

**RN:** Yeah, you're right. My definition is "stealing money from old people slowly". So the idea is that you do it slowly enough that they don't notice. But at some stage, they notice.

It's a really interesting point. Have they already noticed? Not really; I don't think so. I mean, money is… you probably have a lot of friends that are doing that with their money, but the big institutions aren't.

It's when the big institutions start doing that… I don't think it's really begun yet. So I think that's absolutely right: You try to do it slowly and at some stage the people work it out. And **what you get then is a collapse in your exchange rate**, because they rush out of your exchange rate.

Now, I'm watching the euro trade today. **The European Central Bank has categorically told people it's going to inflate away their debt.** It's a target of the ECB to inflate away debt, and the exchange rate went up. So clearly, markets take a while to work these things out.

**NJ:** One thing we never had before is the thing that we're using right now in order to talk, and that's a global network of information. I don't want to get into too many details on Bitcoin, this not a Bitcoin discussion; but what is happening in Bitcoin circles right now… **there are thousands, tens of thousands, maybe hundreds of thousands of young people talking about exactly this: getting out of the inflating fiat money system.** So even if Bitcoin disappears tomorrow, the idea of why you need it doesn't go away. We just talked about why we're needing it. So my question is, isn't it possible that information travels quicker than before, that people react quicker than before?

**RN:** Yeah, so one of one of the problems I have as a financial historian is to believe that people get smarter, because I don't really see a lot of evidence that people get smarter. You know, when I look at all the mistakes that happened in this cycle, **they seem dramatically similar to the 1866 cycle**.

*I don't really see a lot of evidence that people get smarter. […] Because we believe so much in our intelligence these days, we have a false certainty*

So I don't base a lot of what I'm saying on the idea that, you know, information is quicker and people are smarter – probably quite the reverse. I have written an introduction to the modern edition of *Extraordinary Popular Delusions and the Madness of Crowds*[5] suggesting that **because we believe so much in our intelligence these days, we have a false certainty.** And it's when that false certainty ends that things can be even worse than they were in the old days.

What you're suggesting is that we have bigger, better-connected groups now. But groupthink is a well-known phenomenon, and **the ability to do group think is now on a global scale.** So I wouldn't agree with you on that.

But back to the key point we keep coming back to here. There are two sets of money. You mentioned all those young people, that they're acting with their own money. Actually, they're acting quite a lot with government money and stimulus checks. But anyway, that's now their money. And then there's the institutions, and this is the interesting thing. You'll see a lot of your friends moving money because of this, **but the institutions can't. They simply can't.** So if they represent 80% of the liquid wealth of an economy – I made that number up, but let's say it's 80% of the liquid wealth of an economy – they're going to be trapped.

So I think anybody watching this will conclude that one of most important things is not to have your money in a fully regulated… you know, if that regulated entity already has its money in gold, if it really has it offshore, then fine, there's not a problem; but a regulated entity holding domestic assets is going to find it very difficult to do what all those young people are doing in trying to escape this system, because if they can't escape then they can't inflate away their debts.

**RS:** Russell, I would like to touch on a topic that is somewhat related. I think Hayek would have said it's a bit of a "weasel word".

Back in the day, everybody was talking about the SDRs [special drawing rights]. **And a friend of mine, Peter Millar, once said money used to be "I owe you gold", then it became "I owe you nothing", and the SDR would be**

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[5] MacKay, Charles: *Extraordinary Popular Delusions and the Madness of Crowds: The classic guide to crowd psychology, financial folly and surprising superstition*, 2018 [1841]

**"who owes you nothing?"** And I think that this trend regarding CBDCs, central bank digital currencies, is coming on the back of the whole crypto trend; but do you think they are something that will be implemented at some point? I mean, there was the Bank for International Settlements coming out with a big paper[6] that was backed by all the important central banks. And it is definitely something that the ECB is also considering.

Wouldn't it be fantastic, if you have a digital account with the ECB, you have your e-euro, and then you just charge deeply negative rates as [Kenneth] Rogoff suggested.[7] So what's your view on these CBDCs?

**RN:** Yeah. I think this is the same Peter Millar that I know from Speyside in Scotland, and last time I saw Peter, he was removing a fishing hook from my face! So I owe him a great deal, not just for monetary and financial advice!
Yeah, so what people need to look at is that BIS published a paper on crypto not long ago; and to show how important that is, it was presented by Agustín Carstens, who's the head of the BIS. So clearly, we think this is important.

*Private sector crypto is very dangerous for the banking system.*

I think there are two key conclusions that he points out. First of all, **private sector crypto is very dangerous for the banking system.** It's a way for the banking system's funding in the form of deposits to start disappearing. So they have to look at that from a financial stability perspective. You'll know that there's legislation before Congress to track who owns crypto. **That's not to ban it, but to track who owns it. I think that will put people off it.**

**So I think the central banker is very concerned that crypto can undermine the entire stability of the banking system. And I think we had better pay attention to him.**

Now, the second thing is what you mentioned, that the central banks themselves can develop their own crypto. Now, that's obviously a very different thing. Because if money starts leaving deposits and going into the central bank's crypto, the central bank lends it back to the commercial banking system; so it doesn't ultimately become a disruption or a run on the bank. However, what it does do is, the role of the central banks, or the intertwining of the central banks with the commercial banks, goes dramatically higher. The two become completely entwined, and I don't think Hayek would like that.

But anyway, that is what happens if you use too much crypto. It's interesting, because Carsten says, **"When we build this stuff, we had better constrain the supply of it".** Because we don't want a situation where we're effectively owning all the deposits and giving it out to… you know, these things wouldn't be commercial institutions anymore, they'd be deeply politicized.

So my conclusion from that, and it really is based on Carsten's paper, is that they will actually constrain the supply of crypto; they will create a digital central bank currency, **but they'll be very careful not to make it too big** in case it too

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[6] "Central bank digital currencies: foundational principles and core features", BIS, 2020
[7] Rogoff, Kenneth: "The Case for Deeply Negative Interest Rates", Project Syncdicate, May 4, 2020

quickly just strips all of the assets or all of the liabilities in the form of deposits out of the commercial banking system.

**RS:** Makes sense. We have only briefly touched on the topic of gold, Russell. In summer it was really easy to be a gold bug, but now it seems it's the most hated thing! I'm getting emails and phone calls from many, many people who are a bit worried about the price of gold, obviously, I mean, yields are up since summer. It was a big move, although the absolute level is still fairly low. I think that crypto, or especially Bitcoin, stole a bit of the media attention from gold. But what's your case for gold going forward? I mean, obviously we don't have to talk about price forecasts. But where do you see gold in the portfolio? As you know, from an asset allocation point of view, what would you think for an average investor should be the allocation?

*They will create a digital central bank currency, but they'll be very careful not to make it too big in case it too quickly just strips all of the assets or all of the liabilities in the form of deposits out of the commercial banking system.*

**RN:** Yeah, so just to prove that I don't just specialize in silver, there's my British sovereign, my little, tiny piece of gold, which can still buy you a dinner at the Savoy, apparently, although I'm not the sort of person who goes to the Savoy for dinner!

So, on financial repression. What we had initially is interest rates going up, and the relative yield of gold has been hit. Obviously, gold doesn't have a yield, but its price has been hit.

The crucial thing now is, do we cap interest rates? Because that's when everything changes. If we just stand back, and maybe bond yields go up and up, maybe there's another 100 basis points where gold doesn't do well, because people move out of gold and look for that yield.

But if we cut yields, then everything changes. And obviously, that's what happened today, they recently announced a yield cap. Because now what you're told is it doesn't matter. I mean – this is for European bonds – it doesn't matter what your nominal yield is, you know it's got to be below inflation. So why on earth would you take that nominal yield, which in many cases is still negative?

*You have to reconsider, and you have to reconsider gold.*

So you have to reconsider, and you have to reconsider gold. And the reason you reconsider gold is because one of its best relationships is with real rates over the long term. And **the central bank has guaranteed you negative real rates; that's actually their target in the European Union.** And then it goes to the second level, which we have discussed throughout this conversation, which is macroprudential regulation: trying to force you to own things you don't want to own. So it's not just that, "Hey, there's negative real yield curve", it's massive control over what you're allowed to own.

And the beauty of owning one of these *[picks up gold coin],* is that it still goes into your jacket pocket, if you want to go from Italy to Switzerland. So it's still bid up. It's bid up, if you like, because of more government control.

**RS:** Makes sense. We're already coming to the end. Niko, do you have a question?

**NJ:** To be complete, we do have to ask you for your case against Bitcoin, because all the roles of gold that you have just described are fulfilled by Bitcoin right now; it's even easier to cross the border. So do you think it will end badly? What will it look like?

**RN:** I put the two assets together, Bitcoin and gold, and then I work out what I would call "anonymity value", which is the value of nobody knowing what you're doing with your money. Actually, gold has relatively low anonymity value, because most of it is tracked. People know where it is.

The people who buy Bitcoin, whom I speak to on a regular basis, tell me they have complete anonymity and no one will ever be able to find them. So **I don't know what percentage of the total value of Bitcoin is "anonymity value", but it is a very, very high percentage.** Now, let's say that Congress passes this piece of legislation, which was, interestingly, introduced by the Republicans, introduced by Trump before he left. One of the last things he did was sign this piece of legislation to track who owns Bitcoin. What is the percentage fall in Bitcoin the day that you know that the government can track it?

*The government isn't going to be able to track your Pokémon cards, but it is going to be able to track your Bitcoin.*

So… I prefer Pokémon cards to Bitcoin, because the government isn't going to be able to track your Pokémon cards, but **it is going to be able to track your Bitcoin.** There's not a lot of anonymity value in gold. And that is why the relative case for gold versus Bitcoin. If Bitcoin stays an open "black hole", through which people can escape taxation and regulation, then that will be kind of the breakdown of Western society, and that's why it's not going to be allowed to happen. **If anybody chooses to take their money into a deep dark black hole, where they're not subject to taxation or regulation, then society collapses, so it's not going to be permitted.**

**NJ:** And gold will be permitted? Because gold will also be a way to escape financial repression, and you said that the government will shut down all the avenues, but gold is also an avenue.

**RN:** Well gold is, as Ronnie pointed out earlier on, it's already very difficult to buy gold if you're a financial institution and – we keep coming back to this thing – most of the wealth of the world is tied up in regulated financial institutions, and it's very, very easy to stop them owning gold. Now whether we ever get to the stage of "I ban you from owning gold" is a different issue. Maybe that will come. But for most of the savings in the world, it's simple.

**NJ:** I see.

**RS:** I mean, in Germany, I think 2,000 euros is the limit for buying gold without showing any ID. Over here in Austria it's 10,000 euros, but it's going down every couple of years. So that's definitely also another form of financial repression. Russell, as I mentioned at the beginning, you founded The Library of Mistakes. So what would you add to this library, as you think about what's happening at the moment and what happened last year? What would be the biggest mistake? I mean, today, I just read that the head of this agency that is selling Austrian government debt said, "I cannot 100% rule out that at some point, we will sell

Austrian government debt at positive yields". I thought, well, that's pretty funny. I mean, five years ago nobody would have expected such a statement. **What would you add to the Library of Mistakes?**

**RN:** Yeah, so the great South Sea Bubble was kind of one of the early ones, though not the first. And one of the greatest jokes through my entire career has been that somebody once set up a company (it was in a listing prospectus) that said it was a company that was to be so secret that nobody was to know what it was to do. **Well, that's a SPAC!**

And for my entire career, we just thought that was ridiculous; we'll never see anything like that again. But that's a SPAC. I discovered last week that there's a new SPAC called "Another Acquisition SPAC". And there is now going to be an ETF called the FOMO ETF, the fear of missing out ETF.

**RS:** And there is the vegan climate ETF, Russell!

*Yield curve control, in my opinion, is a disaster for Europe.*

**RN:** So I think these are things that we will have framed and put into the Library of Mistakes, you know, that these are the signs that, in those assets anyway, we're well and truly in a bubble. That's not the same as saying we're in a bubble in real assets. But in those assets, I think we're there.

By the way, I think **today will go down in history as one of the greatest mistakes in the history of Europe. Yield curve control, in my opinion, is a disaster for Europe.** And it may take many years for that disaster to unfold: economic, political, social. But this is the biggest mistake I've ever seen by a developed-world central banker. I've seen lots of bigger mistakes by emerging-market central bankers. But this one really takes the biscuit, and it's really quite frightening. So, sadly (and I do mean sadly), I think there will be yield curve control by the European Union. I mean, I'm sure others will follow in due course, but it's a sad day for everybody when this is where we've got to. So the other mistakes are mostly humorous. This one isn't.

**RS:** I agree. Russell, thank you very, very much. We promise, if you should come to Vienna once this is all over and we're allowed to travel again, we will host you for *schnitzel*, for *apfelstrudel*, for good glasses of wine and for the tour through the Austrian Mint that I promised. Be our guest! Thank you very much, Russell!

**RN:** And don't forget the beer!

**NJ:** No, we won't; thank you very much!