MACRO Voices
with hosts Erik Townsend and Patrick Ceresna

Jim Bianco: Still No Landing, and Inflation is Not Transitory

September 12th, 2024

Erik: Joining me now is Bianco Research founder, Jim Bianco. Jim, it's great to get you back on the show. Last couple times that we had you on, you made the prediction that if the Fed did what they have now done, which is to wait until September before any rate cutting, they would risk the appearance of having become political. I'm going to go out on a limb here and say, I think that they've crossed that Rubicon. The Fed looks political. What are the implications of that? Does that really change anything?

Jim: Yeah, the Fed has definitely become political. Let me back up and remind everybody what I said in our last conversation in May, whatever the Fed policy was going into Memorial Day, were they tightening? Were they holding or were they cutting? Usually, will make it until Election Day. So to be clear, because people kind of misunderstand what I'm saying, if they were tightening going into Memorial Day, they could continue to tighten through the summer all the way to election day. If they were cutting, they continue to cut. They were holding because their last move was in July of '23 with their last rate hike. So from July 23 to Memorial Day this year, they were holding. That would suggest they would hold through Election Day. Well, as we talk a week before the Fed meeting with over 100% chance that the Fed will cut rates at their September 18 meeting, over 100% means we're debating whether or not it's going to be 25 or 50 basis point cut, not if there's going to be a cut. It looks like the Fed is going to break from its historical tradition, and it's going to cut rates in September of an election year. In other words, change policy in September of an election year. And that is unusual. It does look like it's going to be very political. The interesting thing about it is the Fed could cut rates, and both candidates could wind up, winding up, you know, criticizing the Fed for the same reason that the Fed could cut rates, and the Trump administration could put out something saying, see, the economy is falling apart. You know, the Biden-Harris administration has done a terrible job, even Jay Powell acknowledges it. And the Biden-Harris administration could say, why are you doing this before the election? To give them a talking point as well. So they're looking to be very political. So yes, they've decided to cross that Rubicon.

Now, I've talked to some Fed officials about this exact topic, and their comment to me was, no matter what we do in September, we're going to be criticized. If we don't cut, we're going to be criticized. If we cut, we're going to be criticized. We might as well ignore the politics and do what we think is going to happen. And that seems to be what they're doing. They're believing the data that the economy is cooling and that a cut is warranted at this point. Final thing about this topic,

I also said back in May to the line that the Fed is political, but not partisan. So, what I meant by that back in May, and I think it applies here, is, no, they don't sit around the FOMC table saying, okay, let's cut to the chase. We really want Harris to be president, because they tend to be more Democrat than Republican at the Fed. So what can we do to get Harris elected? They do not, do not do that. So I don't think they're partisan, and they think of it in those terms, but they are political in that they are worried about their reputation, they are worried about the ramifications of their policies in Washington, and they care a great deal about that. But given what they've told me, and I think it's right, if they don't move, they're criticized. If they move, their criticized, whatever, if September 18 comes up, they're going to be criticized whether they do something or don't do something. So they've kind of said that all cancels each other out. We've just decided that the data is cooling enough that it warrants a rate cut, and that seems to be why they're doing it.

Erik: Jim, you laid out a scenario for me off the air where China's economy actually figures into this whole story. Give us the backstory there. How does China fit into this story, and how does it affect the narrative?

Jim: So we'll talk about this a little bit later. But let me just say, yes, I am, I've been bearish on bonds. I still am, for the moment, and I am very surprised that we've gotten the 10-year yield down to 3.66%. Part of my surprise has been, I don't think you can make a case with the economic data in the United States debt interest rates should be this low. So, the question is, alright, let's look outside the United States, and what are we finding outside the United States? An acknowledged story that isn't maybe getting the coverage that it should. Chinese economy is in a world of hurt right now. It is really in a bad place. Their stock market is down over the last two years by over 25%, at the same time, our stock market is up. And I'll remind everybody that China still has rules on their books, that if you are a research analyst in a brokerage house in China and you write a bearish report, you can be prosecuted. If you short sell their market, you can be prosecuted. So, they are throwing people in jail that try to short their market or bad mouth it, and it's still down 25% over the last couple of years. At the same time, the S&P is up 45%, their interest rates are at an all-time low, 2.1% on the Chinese 10-year bond. Now, data goes back to 2005, but they are definitely at a 20 plus year low on that data as well. So that lower interest rates isn't saving their economy. Their second quarter, GDP grew at 5%. Now, that sounds like a lot from Western market perspectives, but for high growth, emerging markets like China, 5% growth, there's only two times in the last 45 years it's been lower than that. Tiananmen Square, 1989 and the COVID shutdown, and now their economy is in a world of hurt. Why does that matter? There are bigger consumer markets than the United States. They buy more cars every month than the United States or Europe. They consume more gasoline every month than the United States or Europe. If their consumer economy is really slowing, now you look over and you see Brent crude oil, the day we're recording is under $70 for the first time since 2021, that's not an indication of what's happening in the United States. That's an indication of what's happening in China. If I look at the Bloomberg commodity index, that is approaching a three-year low, that is an indication of what's going on in China, not necessarily an indication of what's happening in the United States and or in Europe.

Now, what makes that surprising is the Chinese are command and control economy. They are a communist government. It's always been believed that the Chinese, a Politburo, will send out the word down on high banks. Please start lending money, people. Please start spending money, please, start initiating new projects to keep the economy moving. They still have that ability to do it. And for the 25 years I've been watching the Chinese economy, probably Erik, like you have every couple of years, people say, well, at one point, the Chinese are going to run out of the capacity to do that. Okay, I've heard that 15 times over the last 25 years, but maybe this is the time that that's finally starting to happen and that the Chinese economy is really in a bad place. It is killing demand for commodities. It's killing demand for energy. Those prices are way down, and that's what you're seeing world interest rates respond to, especially in the developed countries, is that lowering of commodity prices and that lowering of energy prices, not because of what's happening in Europe and/or the United States, but what's happening in China.

Erik: Now, one of the predictions that have been made for many years is that China had historically been a huge buyer of US Treasury debt, and that they would eventually stop doing that, and it would cause all kinds of problems for the US. In many ways, that story already came true. They really have divested a lot of their treasury holdings, but it has not caused any problems, any significant problems for the US, at least not so far. So, are you saying that it's now about to start causing those problems? Is that where you're headed with this?

Jim: Well, I'll throw in the other side of the equation now too. The Chinese holdings of US Treasury debt actually peaked in 2012, so it peaked 12 years ago at about 1.2 trillion. I'm confident enough in remembering that number correctly, and it's down probably 20% to a third. So, they've been divesting themselves of treasuries for the last 12 years. Now, a big reason that they're doing that is, remember that, like the conveyor belts, that, if you want to think of that metaphor, they produce product, put it on a boat, send it to the United States. We pay for that product with dollars. What are the Chinese going to do with all these dollars? Well, they're not going to convert them all to Yuan. You know that that would affect their foreign exchange market. So, they recycle those dollars into US Treasuries. Well, the trade with China, especially since the trade wars under the Trump administration in 2018 is down, and COVID and the rebound from COVID never really recovered the pre-COVID levels. So, we're buying less stuff from China. We're still buying it, you know, significant amount of stuff, but less than we used to. So that conveyor belt, if they send them stuff, we send them dollars. They recycle those dollars into the United States. They're still doing that, but they're doing that at lower levels, which is why their full holdings of treasuries has been falling now.

On the other side of the equation, there's a new country that is the largest single holder of treasuries, is Japan, and they've overtaken China a couple of years ago, and they have been constantly hoovering up Treasury securities under the yen carry trade. So, borrow money in Japan at somewhere near zero interest rates and then go out and buy something that yields more. Now, a popular product that they've been buying has been Mexican treasury bills, because Mexican treasury bills yield over 10%, so you can borrow at zero in China, you could buy a Mexican treasury bill that yields 10%. You have to take the currency risk, can't really hedge it. By the way, that trade has probably produced you more profit than owning the

NASDAQ over the… it actually has until about a month ago, when the yen carry trade started to get unwound, and now that's been putting that at risk as well. Now, wait a minute, shouldn't that yen carry trade unwind in Japan, being the largest Treasury holder, be bearish for bonds? Yes, it should be, but they're rallying. There's something else that's going on there that seems to be a bigger positive in bonds, than it is the negative of losing that yen carry trade in bonds, and I think that is the slowdown in commodity prices, the fall in energy prices, driven by the Chinese economy slowing. So, to answer your question succinctly, yes, you should probably see them reduce their purchases of treasuries, but they have been for 12 years. But on the margin, what we really should be looking at is Japan and whether or not they're going to change, now that the yen peaked at 160 and it's pulled back, and there's some question about whether or not the yen carry trade will continue.

Erik: So will the yen carry trade continue? And what will the knock-on effects be to the US economy? And while we're at it, let's also cover the landing situation. Are we at no landing, soft landing or hard landing in the United States? And where are we headed with inflation?

Jim: All right. So as far as the yen carry trade, the answer is, it should continue. It's still an attractive trade. Now, what happened to cause that unwind? July 31 was the Bank of Japan meeting. July 31 was also the Federal Reserve meeting. And the Bank of Japan met when all the US Americans were asleep, they raised rates 15 basis points. Now, they operate a little differently than us. Market thought that they'd raise rates between 5 and 10, and they raised rates 15, and they made some noise about that they might not be done raising rates. So, the takeaway here is, they surprised with a bigger rate hike than people thought, and said, there might be more of this. Well, if you're a levered trader, I am borrowing a lot of money in Japan, financing it at their funds rate, which is at their repo rate, which was around five basis points are effectively zero, and buying a bunch of Mexican T bills, or US 10-year or something that's yielding a lot more and have no currency risk. I don't want uncertainty anywhere. So, when the Bank of Japan surprises me by raising rates more than I thought, surprises me by suggesting that there might be more, surprises me that these rate hikes are strengthening their currency, weakening it against foreign currencies. As a levered yen carry trader, this is bad news for me. I don't want their currency to strengthen. I don't want uncertainty to cause volatility, because I'm a very levered trader, I get out, and that's what drove the yen carry trade to be unwound. Where are we now? We're still at 15 basis points on their carrying cost or their official discount rate, you know, the repo market. There, they've backed off after all of the market gyrations in early August about saying that they might raise rates more, they didn’t close the door on it, but they became a little bit more ambiguous. If I’m a yen carry trader, I'd have to look and go, there’s still practically free money in Japan. Their currency ever settled out, at whatever level it wants to, just volatility, go away, I should get back into that trade. And I suspect that that you might see a resurgence of that trade, largely because it still exists. The underlying fundamentals that make it attractive still exist. If the only thing holding everybody back is the currency volatility, but that might not last much longer. So, I suspect you will see another leg in the yen carry trade.

Last thought on the yen carry trade, it's usually, you borrow in Japan and you buy something with a yield. Well, you've got the 2-year note at 3.60 in the US. I've mentioned a couple of times

you've got 10% on three-month bills in Mexico. That kind of trade is what you want to do. What they're largely not doing, is what everybody assumes they're doing. Oh, yeah, we're borrowing in Japan at zero, and we're buying Nvidia, or we're buying the Magnificent Seven stocks. Yeah, if you're going to buy the Magnificent Seven stocks, given all the volatility, you could charge me 5% of carrying costs. You could charge me zero, because those stocks are so volatile that extra carrying cost and taking their currency risk is really not that important. So, I don't think that you're doing that trade in Japan to find a way to buy Microsoft or Nvidia or something along those lines.

Now, to your other question, as far as the economy, you know, Wall Street likes airplane metaphors. There's the soft landing, which is a recession. There's the no landing, which is the camp I'm in, which means that the economy continues to grow at its potential. In other words, it is just cruising along, and it's not showing signs of any kind of a slowdown or a recession. And then there's that nebulous middle, the soft landing. And the reason I call it the nebulous middle is, the soft landing has no real definition. You know, if Wall Street forecasts a soft landing, it has a definition. Joe Biden says we're going to have a soft landing. In fact, he demanded that we're going to have a soft landing in the State of the Union address. And he said a soft landing just means the inflation rates is going to come down. That's all he thinks it means. And over the weekend, Janet Yellen said we're going to have a soft landing, and she had some three paragraph definition of what it was, and it's completely different from Joe Biden's definition, and it's completely different from Wall Street's definition. And I've often quipped, Wall Street loves to forecast the soft landing, because it has no definition. So, I'll tell you I'm going to have a soft landing, so in a year, I can give you a definition to tell you I'm right. Now that I've said that, I'm in the no landing camp. The reason I'm in the no landing camp is, when I look at the US economy, I don't see real signs of a slowdown. I see GDP growing at 2% to 3%, I see the Atlanta Fed GDP tracker is still saying that we're going to grow above 2% this quarter. Economists have a phrase called potential, it's not an observable measure, but it's what should the economy do if no one is slowing it down, no one is speeding it up, it should grow at what is known as its potential, that is estimated to be between about 2%-2.5%. Well, that's exactly what it's been doing for the last eight quarters, and that's what the Atlanta Fed GDP says it's going to be doing from here. And so therefore, when I look at the US economy, I don't see many signs that we're in deep trouble. And so, I still remain in the no landing camp, although being in the no landing camp, I am as frustrated as anybody else that we have a 3.66 at the time of recording, 10-year note, which is very, very surprising.

Erik: How should we interpret what's happened with the Bank of Japan, in terms of whether it was a policy error or it's, you know, what we can expect more of and so forth. At least the way I experienced this whole thing, it felt to me like, first, the BOJ hikes rates. They didn't think it was that big of a deal. The market freaks out. And it felt to me like the BOJ kind of came back, mea culpa, and said, oh, we didn't really expect it to have that big of a result. We didn't mean it, guys, you know, we're rolling it back. Is that not the way, the right way to interpret it? Because it sounds, from what you're saying, like this really is an ongoing thing. The yen carry trade is back in full force, and the policy error that we thought might be leading to its demise is now forgotten, is that the right way to interpret it?

Jim: So, I'm going to give you an answer that's probably going to get me in trouble with a very, very cohort of people listening to this. Ueda, the Bank of Japan Governor who runs the Bank of Japan, is an MIT graduate. He had a hall, he was there with Draghi and with Bernanke, all the central bankers, the Economics Department at MIT. And I like to quip that the MIT central bankers, if you say to them, hey, you've got this giant carry trade that's going on with your currency because of zero interest rates, they'll turn to you and say, oh yeah, well, show me the measures of how big it is. And I would say, well, when somebody engages in the carry trade and they write a trade ticket, there's not little box in the corner that says, yen carry trade, please take it off. And therefore, I could tell you how much there is of the yen carry trade, but intuitively, I can tell you that the underlying fundamentals, and the strong circumstantial evidence that we see in the market suggests there's a giant carry trade around your currency, in your funding rate. And the MIT graduates would say, oh, so you can't measure it, so maybe it just doesn't exist at all. Maybe you're grossly overstating the case, and I shouldn't worry about it that much. And then they go ahead and say, given the strong inflation in Japan, because inflation in Japan is finally above 2% on a sustained basis for the first time in decades, and the idea that it might stay there, they correctly looked at their economic data and said, maybe we should be raising rates, and let's get going. And they raised rates a little bit more and said, we should raise rates after that. And then the yen carry trade blew up, and the MIT grad said, oh, I guess there was one, even though we couldn't really measure it. And that's where I think they got surprised by it. So now everybody who's got an MIT grad is going to be hating me on saying that, strong letters to follow. But I think that that's where their fundamental mistake was, which is why they did a bit of a mea culpa with it afterwards, when we had all of the volatility. You may remember August 5, when the VIX index in the pre-NYSE, in the pre-NYSE hours, got as high as 60 intraday and the S&P fell 3% that day, was down almost 5% intraday at one point. You know that was all part and parcel of that toxic reaction to the yen carry trade unwind. So at least now those MIT grads over at the Bank of Japan will say, okay, maybe we can't measure it. I can't give you a chart to show you how big the yen carry trade is, but will acknowledge that that is a thing that they should have been a little bit more cognizant of, and the way you become a little bit more cognizant of it is, you don't surprise the market. The Fed has a phrase for this forward guidance. You kind of drop hints in the weeks leading up, and we might go 15 basis points, we might say that we're not done with that 15 basis points. We're going to keep going and to leave the market with this impression that this is going to happen. And slowly, over time, they could kind of adjust to that reality, instead of surprising them all at once. On July 31, on it, and again, the reason why in the US we didn't really notice it was, literally, about 10 hours later was the Federal Reserve meeting, and that kind of sucked up all the oxygen down that day when it came to central banks.

Erik: Now, the other topic that you and I have discussed in past interviews has been secular inflation, and you've generally sided with me that we're more likely to be in a new secular inflation. Is that still your view? How has that view evolved since we last spoke? What do you see in terms of the secular inflation forces that are starting to press on the economy?

Jim: I still think we are still in a secular inflation. And to put that into simple terms, I think the cycle turned in 2020, that the 40 year bull market in bonds ended when the 10-year note hit 50 basis points, or half a percent in August of 2020. I think that the inflation cycle bottomed at that point too, and that we've seen inflation go up. Now, it hit 9% in June of '22, it's at, I mean, year over year CPI, it's at 2.9% now. It's expected, the day after we're recording, is going to be the August CPI is going to come out. It's expected, year over year, should fall to about 2.5%, because you're dropping a very high number from the August '23 CPI number, because crude oil prices were a lot higher, and you'll probably replace it with a much lower number this month, right now. So, I think what you're going to see in terms of the inflation rate is, it's going to probably go down around 2.5%, but I think cyclically, we're probably going to be at a low. We're not going to get back to the Fed's 2% target right now. So, I've been of the opinion that the new level of inflation is somewhere between 3% and 4%, for the last 14 months, it has been around 3% or 4%, it looks like it's going to dip below that because of what they call the base effect here, because of what crude oil did to CPI a year ago. But I think this will be short lived, and will be kind of rebounding later on in the year, back to that 3% level. So I am in this idea that inflation is still not really behind us.

Now, that brings up something else that you know kind of goes with what I was talking about with the no landing earlier. But what about the labor data? That the unemployment rate has gone as high as 4.3 and now it's 4.2, that we triggered what is called the Sahm rule. Claudia Sahm's rule that when the three month average of the unemployment rate gets half a percent above its one year low, that the US economy is already in recession, that we had a big revision down in the payroll report of 818,000. There's a debate on Wall Street, and this goes to really the secular inflation story, that we have a measurement problem with the labor market, and that measurement problem is because the way we measure the labor market is through surveys. We do the household survey asking 60,000 households. How many people in those households have jobs? How many people are looking for a job? From there, we calculate the unemployment rate. We do an establishment survey. We survey about 1/3 of the payroll, so it's about 65, 70 million people. I think, actually, it's more like around 55, 60 million jobs. We surveyed companies that employ about 55, 60 million people every month, and we ask them how many people they're employing, and from there, we get the non-farm payrolls report. These surveys are adjusted by population. Well, up until 2020, demographers could pretty much give you a very good estimate of where the population was going to be next year, the year after, the year after that, that changed in a dramatic way around 2021, and it changed because of migration. In 2020, 2021, the US population was growing at 0.2% or 20 basis points a year. In 2024, it's going to grow at something around 1.1 to 1.2 or 110 to 120 basis points. That would be a 30-year high and a dramatic turnaround and a big surprise. Where is all this population coming from? There's no baby boom in this country. It's coming from migration, coming from people coming over the southwest border. The unemployment rate, the non-farm payrolls report and the rest are good surveys, assuming that the population growth of the country is low, stable and predictable. It's high, chaotic and unpredictable right now, that brings into question whether we're actually measuring the labor market correctly, and again, it's because of this giant population growth. And I'll give you an example in the payroll report revisions that came out two weeks ago, 818,000 reduction, and that was found by, there's 818,000 less jobs than we initially

thought between April of 2023, and March of 2024, that was the revision period. Those revisions came from looking at tax returns and unemployment data in tax returns. Goldman Sachs pointed out that their estimates are, what happened was, there was actually a reduction of around 300,000 jobs, but the other 500,000 were people getting paid under the table. So, what we wound up doing was, we wound up basically getting rid of higher cost employees that withhold taxes and replacing them with cash employees that we pay under the table. And that’s what Goldman's point was, is that a majority of those jobs were not lost, they were replaced with people that are not paying taxes. Remember, it was tax returns and unemployment insurance on tax returns that drove those revisions. Well, if I'm paying people under the table, they're not showing up in tax rolls.

So, the correct assumption is, we lost 818,000 jobs. If the population growth was low and stable and predictable, that would be a good assumption. But since it's highly chaotic and unstable and unpredictable, that assumption should be called into question. Where do we see this in the data? If you look at the retail sales, in the consumption data, the US economy is seeing people buy and spend money like crazy, seeing that retail sales are going very strong. We're seeing the savings rate falling as well, and people are surprised by all this consumption. And no, it's not just that prices are up because this is after inflation data we're looking at. Maybe another answer could be that there's actually more jobs in the United States than we think. Because what is the biggest thing that drives consumption or retail sales? You have a job and you have a paycheck, and you go and you spend money at the store, even if you're not a citizen of the United States and paying taxes, you still have a job in a paycheck, that you can spend money at the store, which is why we're seeing such strong consumption numbers, which is driving the economy. So, if the economy is stronger than we think, and if we're having a hard time getting to that 2% target, then looking at the data, I think what we're seeing is a situation where the economy might be stronger, might be pushing demand, might be keeping those inflation numbers up. Now, there will be a seasonal base effect dip here, because crude oil prices got about $95 in September of last year, and that held up all of the inflation numbers. But I think once we get beyond this, we might see the inflation numbers rebound back into that 3% to 4% range. We're there right now. We're 2.9 and change, and that we are still in a much higher inflation era. And if the Fed is going to conclude the labor market data is cooling and it's not a measurement problem, and they're going to start cutting rates aggressively, and the market is going to signal to them you need to cut rates 10 times. I fear we're going to overdo this, and I fear we're going to stimulate, and that the second half of ’25, we're going back to inflation problem again. Not just that, we're in a 3% inflation world, but we might actually be in an inflation problem.

Erik: Okay, hang on a second, Jim. Because as I take a step back from all this, what I'm hearing above everything else is, there's a huge disconnect around rate expectations. Almost everybody is just chomping at the bit, waiting for that announcement to come where the beginning of the cutting cycle happens. And don't worry, there's going to be a whole bunch of these rate cuts coming. It's going to be 1, 2, 3, 4, 5, a whole bunch of rate cuts coming, coming, coming. There's going to be five or six rate cuts. We're going down 300 basis points. Sounds

like you're saying, really, the at least in longer term rates, the 10-year rate, any effect it was going to get is probably already been baked in. Is that right?

Jim: Yes, that is right. As a matter of fact, I'll even go that Citibank is predicting that the Fed will cut rates 125 basis points before the end of the year. So that's 525 basis point cuts over the next three meetings. You know, simple math says that's 50, 50, and 25, the order to be determined. At the moment, it looks like maybe 25 in September, then a 50 in November, and a 50 in December. So, the reason I bring that up is, yes, everybody knows, or everybody expects, the Fed is going to cut rates in September, and it is going to be the beginning of a big campaign to lower interest rates, and lower them a lot. That is why the funds rate, at 5 to 5.25, call it 5.375, you know, the midpoint of it. And the two-year note, as we are talking right now, is trading at around 3.60, so the 2-year note is trading 175 basis points, 180 basis points, below the funds rate. The last time it traded this far below the funds rate was the financial crisis of 2008, when everybody was panicking, the world was falling apart. What it tells you is, yes, you're going to get 7, 8, 9, rate cuts, markets already priced it in. So, if you get 7, 8, 9, rate cuts, in theory, bond market should be unchanged for the next year, by the Fed cuts rates nine times. What's going to get a further rally in bonds that would need 10, 11, 12, 13, rate cuts? That would mean we're going into recession. What would be a good signal that we're going into recession? If you saw credit spreads widening, if you saw the stock market sell off well in excess of 10%, neither one is happening. Stock market is around 4% off its all-time high, which was set in July. Credit spreads are tight relative to the last couple of years. They've widened a little bit, but nothing meaningful. Nothing meaningful. So none of that is happening just yet, right now. So you've kind of got interest rates as an outlier to credit into the stock market, in terms of what it's signaling. Again, I think it's about commodity prices because of China, is what's been the catalyst for interest rates, and why it's not showing up in terms of credit spreads, or it's showing up in terms of the stock market. And if you get any kind of normalization in the bond market, what is normalization? Well, where should the 2-year note trade? If the Fed cuts rates, 7, 8, 9, times, it should trade at a premium above the 10-year note, I mean above the funds rate. So, if the funds rate goes to 3.5, you know, 200 basis points, 8 rate cuts, 2-year notes, you trade at 4%, it's at 3.60 right now. And if the 2-year is at 4%, where should the 10-year be? If the yield curve is uninverted, it should be 50 basis points above that at 4.50, not 3.65, or 3.66, where we are right now. So yes, the answer could very well be the Fed's going to cut rates in September. That's going to be set up to 7, 8, 9, rate cuts. And if that happens, interest rates go up 100 basis points, because we've already priced all of that in. Now, if you want to make the case that they're going to go a lot further, then you got it to make the case, US economy is falling apart. I'm a no-lander, I don't see it. The stock market doesn't see it. The credit market doesn't see it either.

Erik: I'm going to go out on a limb here, Jim, and say that if you're right, it's a pretty big surprise, in the sense that most people are not expecting what you're talking about, for there to be no material change in longer term rates after there's maybe as many as eight Fed policy cuts. If I'm right about that, or if you're right, and the result of that is that people are caught off guard and surprised. What's the consequence of that surprise going to be?

Jim: So just to the first half of your question. You're right. If you look at the Bank of America global fund manager survey, they've been asking the question for nearly 25 years of, something like 200 global fund managers every month, their outlook on various things, including long term and short term rates, and they've never been more bullish than they are right now. If you look at the Commitment of Traders report, and you look at unlevered asset managers and the 10-year note futures, they're the longest they've ever been. If you look at the TLT ETF, which is the iShares, 20 plus treasury, there's been massive inflows into that instrument as well. People think that the Fed is going to cut rates in September, even though interest rates are down 140 basis points from their peak a year ago. They think, no, this is just the opening inning of a massive rally. Now, what gives them that belief that it's the opening inning of a massive rally, which is why they're also bullish in all these surveys, because they don't think the 40 year cycle ended in 2020, they think that we are going to have many more episodes of going to zero interest rates and quantitative easing again and again and again, and that that is the normal course of affairs as we move forward. And that's where I differ from them. I think that that secular era is over right now. And with that secular era being over, I think that it's going to be very difficult to get interest rates down, that 7, 8, 9 rate cuts, unless you see serious and protracted weakness in the US economy, US credit market and US equity market, all three of which are not showing that in my opinion, just yet.

Erik: How should we be thinking about the long term of what is normal? Because certainly, for the last several years, zero, near zero interest rates have been normal. Of course, you and I would say, well, that's not normal. That's only been for the last few years. The normal was established in a much longer time frame. But certainly, there has been something over the last 10 years or so, post 2008 financial crisis, where it seems like there is a decided new normal, where the central bankers have a different participation level than they used to in the economy. Does that mean that we are in a new era where central bank participation is going to be more important and rates are going to be lower? Or are we moving back to historically normal interest rates?

Jim: I would answer this, short answer is, if we weren't in a new era that ended in 2021, 2022, now let me explain, and I'll use Austin Goolsbee, the Chicago Fed President. Austin Goolsbee is one of the bigger doves at the Fed, and has been very adamant that the Fed needs to cut interest rates. And he's been adamant that the Fed needs to cut interest rates because he looks at real rates, that would be interest rates less inflation, and says that real rates are way too high, and because real rates are way too high, that that is a restrictiveness on the economy that is slowing things down. And he would point to the labor data as a sign that these real rates are slowing things down, although I would argue there's a measurement problem because of population growth, as I explained earlier. Well, here's the question, from 2009 to 2022, interest rates were zero. We were in a quantitative easing era, and real rates averaged from 2009 to 2022, and for those that want to know, I'm talking about the federal funds rate minus core PCE, that's the Fed's favorite deflation measure. That rate averaged minus 1% from 2009 to 2022, during the QE period. Well, we're not in a QE period. We ended that. We're in a QT, quantitative tightening period where the Fed has been reducing its balance sheet. So, what is the appropriate interest rate when you have inflation, and you have quantitative tightening? Well,

what was the average real rate before 2009, from 1982 to 2009, it was 2.6%. Today, real rates are 2.8%, they look a lot like where they were pre-QE. So this does bring up an interesting debate, what is the neutral funds rate? Or where should interest rates be? Some on Wall Street think zero. Of course, they have to be zero, because that's where they were from. '09 to '22. Well, we're not doing QE, we're doing QT, we're reducing the balance sheet. We're no longer in a zero period, a zero interest rate policy period. And Jay Powell himself has said in some of his press conferences he doesn't think we're ever going to go back to that unless we have some kind of huge, massive economic crisis, which is what we are not having right now. So, it begs the question, where should interest rates be? Well, if you look at the pre-QE period, real rates are not that far off the average of the pre-QE period, even though Austin Goolsbee, he's been screaming, we're at nearly a 20-year high in real rates. Oh, my God. Look at what it's doing to the economy. What? the economy's fine. It's growing at trend or potential for eight quarters in a row. And are you telling me that real rates should maintain that minus 1% range that it had during QE, when we're not doing QE, or should they be closer to about 2.6 and they're at 2.8.

This brings up an adjacent argument. What is the neutral funds rate? Well, the Fed forever used to say that the neutral funds rate was 2.5%. How did they arrive at that? 2% long run inflation target, which they still believe and a lot of Wall Street still believes. I don't. I think it's more like three, and a half a basis point, R-star on top of that. So, you take the fog long run inflation rate, add a half a percent, you know, fudge factor, they call it R-star, reals on top of that, you get 2.5%. Well, the Fed has been moving that target up. It's up to 2.75. When Jay Powell was asked about it in recent press, or I think in the June one, he said, oh, this is just a kind of a thought experiment, a theoretical exercise and the like, no one really thinks more of it than that. I disagree, I profoundly disagreed with him. I understand why he said it. He said it because what it's implying, is a belief that maybe we're not going back to 2% inflation. We're going to go to 2.5% inflation, or 3% inflation, so that that neutral funds rate needs to move up. And then Mary Daly, at the San Francisco Fed, came out and said, R-star might be closer to 1%. Well, if you've got a 3% to 4% inflation target like I've got, and you put 1% R-star in it, that means that the neutral funds rate is, for a lot of people on Wall Street would argue that they could see that the neutral funds rate is 3.5% to 4%. Well, let me go back to what I said earlier, that Citibank is saying we're going to get 525 basis point cuts by December 31, that puts the funds rate at 4% to 4.25%. If I go with Wall Street's estimate of neutral, 3.5% to 4%, we might be in 90 days, close enough to what we would refer to as neutral. We should be done with this rate cutting cycle in 90 days. Should be done with this rate cutting cycle in 90 days, because we'll be near neutral. But the expectation is, no, this is the early inning, so we're going to go 7, 8, 9 rate cuts, and we're going to go way too far and be way too stimulative and wind up with, like I said, an inflation problem in the second half of '25. Now, I would like to see the Fed address this issue. Why do you still think we have a 2% inflation target? Give me some arguments. Why do you still think that the long run rate is 2.75 to 2.5 when everybody else, and even market measures of the long run, inflation rates are much higher than that. Give me some arguments. The Fed doesn't. They just say, look, it's been 2.5 forever, and it's just going to stay there. Because, remember, the Fed's not partisan, but political. Because politically, it's a good number for us, we'll just go with it, although no one other than the Fed says that that's how far they have to go back to neutral. And they've all cranked themselves up, that there's going to be a lot of rate cuts

as we go forward from here. And the risk is, if you can't answer the question as to where neutral is, you're going to start a journey on September 18, what's the destination? If you can't answer what the destination is, you're going to go too far. And that is the real risk that we face, that has yet to be really articulated as to how far we're going to go and where we think we should stop.

Erik: Jim, I'd like to tie these rate expectations into precious metals, because it's a subject that many of our listeners have a trade on in. So, on one hand, it seems to me like the reason to be long gold, or the reason that a lot of people are long gold, has a lot to do with rate cut expectations. A lot of people think that will be a bullish catalyst. Are you saying that they've got the story wrong and that we shouldn't be long gold here, or is it more complicated than that?

Jim: No, I think that we've got the story right. I mean, with gold, in previous calls, I've been a frustrated gold bull. I've argued gold has got every reason in the world to start rallying, and it seemed to not really find any reasons to rally. And then around February, it really started to take off. I look at gold as being one of, you know, it hedges you against one of two things. First of all, it hedges you against bad things and uncertainty. Monetary policy is running well into the uncertainty camp. And I would argue, where's that uncertainty coming from? You're going to cut rates, and you haven't articulated where you need to go. That's the last thing we were just talking about. So, if you just start cut, cut, cut, cut, cut, cut, cut, cut, cut. Like I said, we could be in the second half of ’25. Whoa, whoa, we went way, way too far in the other direction here and now we've got a problem, and that benefits gold as well.

The other thing about gold, I said too, is, to my frustration with gold, is that we've turned it into a quasi-fiat currency. You know, we trade ETFs on it, we trade derivatives on it, we trade futures on it, that it kind of moves up and down like a fiat. Well, maybe what we could be doing now is finally breaking of that cycle, and that if we're going to wind up with a policy error, and that's what I'm suggesting, is that there's a real risk of a policy error. If this is the start of a big, massive rate cutting campaign, from what I see, if we wind up with a policy error, then maybe we could finally break gold off that fiat currency thing, that it trades on an ETF, that trades in the futures market, and it starts acting like its traditional hedge store value. I think that's what we've been seeing in gold, with the rally that we've seen over $2,500 and all of this seems to be very, very supportive of gold. And I also would find it interesting to point out that in the last five or six years, we've had some epic stories. I've even said this with you on previous calls, Peter Schiff's dreams have happened in the last five years, we have had a pandemic, we have had 9% inflation. We have had gyrations in markets like we've never seen, and gold could not get out of its own way. And then, starting in February, when everybody started talking about, no, the Fed’s got this policy all wrong, and they've got to start cutting rates like mad, gold finally started to take off. And to me, it sounds like, if I had to interpret the gold move, it's in the policy mistake camp, like I am, and it is the policy mistake hedge, and that's what's got it up over $2,500, up a lot from February. And as long as we're continuing down this road, it should be very supportive for its price.

Erik: Well, Jim, I can't thank you enough for a terrific interview, but before I let you go, please tell us a little bit more about what you do at Bianco Research. You're a boutique institutional

research firm. So, for our institutional audience and for our better heeled family office and private investor audience, they can afford your institutional price tag. Tell us a little bit more about what's on offer.

Jim: So, two business lines that we're in, we're in the research business. That's our traditional line of business. That's biancoresearch.com, it is an institutional product, as you said, I am active on social media @biancoresearch on YouTube and on Twitter, and Jim Bianco on LinkedIn. The other product we started about a year ago is, we manage an index called the Bianco Research Total Return Index. This is an index designed to outperform the broader bond market benchmarks like the Bloomberg aggregate index or the JP Morgan broad investment grade index. And there's an ETF run by Wisdom Tree that tracks our index. Think the S&P index committee manages the S&P500. And SPY tracks the S&P500. Well, we manage our index. We intentionally try to change the duration in the credit weightings and all of the other metrics in that index to outperform. And WTBN, the Wisdom Tree Bianco index, WTBN tracks our index. Our index is now up over 5% this year. It is outperforming some of the larger, broad investment grade benchmarks we're trying to beat. And if you want to find out more about our index, you could go to biancoadvisors.com and it lays out a lot about our index and that line of our business, and biancoresearch.com lays out about our research business. And again, you can follow me on all the socials, because I'm still fairly active on all of those.

Erik: And again, that ticker symbol is WTBN, Whiskey, Tango, Bravo, November. Patrick Ceresna and I will be back as MacroVoices continues right here, at macrovoices.com.