R|H RADIO

My Four Children Take Mandarin Because I Fear For The Future Of The Dollar

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JONATHAN ROTH: Welcome to RiskHedge Radio. I'm your host, Jonathan Roth, coming to you from sunny Vancouver. Today, it's my privilege to speak with a true insider about an institution most people know very little about, and yet it has a very powerful impact on not only the United States but the rest of the world. I'm talking about the Federal Reserve, America's central bank. It's been at the center of conspiracy theories and much criticism ever since it was set up by Woodrow Wilson in 1913. And today, I am joined by someone who worked there.

Danielle DiMartino Booth is the author of *Fed Up, an Insider's Take on Why the Federal Reserve is Bad for America*.

Danielle, thanks for joining me.

DANIELLE DIMARTINO BOOTH: Thanks so much for having me today.

JR: So, Danielle, I just wanted to set up this interview because you have an incredible personal story and I want to get to that in a moment. But just give me a brief setup for my audience. Why is the Fed bad for America?

DDB: Well, the Fed is bad for America because it suffers from something that generals and people in the military are very familiar with called mission creep. And despite the fact that its main priority is to capture the buying power of the money in our wallet—make sure that that's not denigrated—it's done so much more and it appears to want to do so much more, that it really did get under my skin because that's not the original intent of the 1913 act. And it's not a political body, but it's become highly political and dangerous, I would add. I call it the fourth branch of the United States Government, but with no checks and balances.

JR: Okay, I'm going to get into all of that that you've just mentioned. But first, why don't you give me some background on how you ended up working at the Fed, because you have a very interesting story.

DDB: Well, I started off, I got my MBA in finance and landed on Wall Street and worked at a great firm called Donaldson, Lufkin & Jenrette. What's most telling for today, if you will, is that I was at DLJ when private equity was just a young pup of an industry. People like Leon Black and the number two at Blackstone, Tony James, used to wander the hallways.

But anyways, I did digress there for a minute. I ended up going to Columbia journalism school at night. I discovered a passion for writing about the financial markets when I was working on Wall Street and decided that that was going to be my retirement plan.

So, there I was, the stock market would close at 4:00 and I would rush uptown to Columbia where I got my second Master's in journalism. And after 9/11 occurred, we all had a little bit of introspection going on. I reevaluated where life was going to take me and decided to not wait until I retired in order to pursue my dream of being a journalist on the markets. [I] landed in Dallas, Texas, where I soon thereafter married my husband, and ended up being read by people like Warren Buffett and one Richard W. Fisher—newly instated president of the Dallas Federal Reserve. And long story short is that he ended up asking me to come work at the Dallas Fed, asked me to come serve my country. I was altogether too happy to do that given what I saw coming down the pipeline, which was a housing crisis of magnificent proportions that could be something we call systemic in nature, globally systemic. And so I felt it was the right time to combine my body of knowledge and my skill set and go serve my country, which is how I landed at the Fed for the better part of a decade.

JR: So, when you first arrived there, you say in the book that you found a very complacent attitude. Describe what you meant by that. What was the environment like?

DDB: Well, I'll just try and contrast it to a trading floor where more often than not, you're smelling red meat, and it might even not be what they're eating. Just a very dog-eat-dog type of environment as opposed to the aesthetic, almost hospital library quiet, place that I stepped into. In the heat of this great housing bubble, my hair was on fire. I was like, God, the world is going to end as far as we can see. I mean, this massive housing bubble is bursting right before our very eyes and to look at the people, my new peers in the research department, there was nothing to be seen, nothing going on. And I said to myself, wow, this is surreal. How can these people not be even minimally engaged, given they are the ones who are going to be on. They're going to be the infantry, if you will. They're going to be fighting this battle. They're going to be fighting this war, and they don't even seem to be plussed. Hence, the complacency you say.

JR: So, do you think it was willful blindness or were they just uninformed?

DDB: Uninformed, no. Willful blindness, yes. In the end, that came to be my perception, but a lot of them simply suffer from let's call it, dissertation-itis. Wow, I just made up a new term. I'm going to have to remember that. And that's that they've study for their dissertations. They've become doctor this and doctor that, and they go into their main career, most of them at the Fed, and really don't expand their group, their knowledge base after that. They continue to try and stay inside of that main body of knowledge that they created when they were getting their dissertations, as opposed to new areas of research that could help policy makers figure out where interest rates need to be.

So, it was very insular, if you will. And if you spoke to the guy who hired me directly into the Fed, who was the director of research—for almost 40 years he had a career inside the Fed—that was his main beef. And that's that we need for our research economists to do more on the ground, every day research to help us make policy, not further the brilliance of their dissertations.

JR: Right, right. Okay, well, you mentioned his name already, Richard Fisher, the president of the Dallas Fed. You worked for him, and obviously he must have been thinking outside of the box to even consider someone with your background. Just given, I mean, personally, from the book it sounds like you actually faced some hostility.

> **DDB:** Oh, I was none too welcome inside the Fed. Again, economists that are trained in the traditional schools of thought, they have to seasonally adjust the data before it's presented so that it is, and it's logical enough. You take the bumps out from, from the ups and the downs of seasonality. But by the same token, if you become too entrenched in that thinking, real-time data ceases to have a place in your thinking. And it was very much real-time data, for example, on what it cost to insure Lehman Brothers, on what it cost to insure the failure of Bear Stearns that became very relevant. And yet it didn't fit into their models, so they completely disregarded it. So, yes, I was definitely faced with hostility because of the types of data sets that were relevant to me that I was looking at that they feared didn't have a place at the Fed.

JR: So why do you think Richard Fisher brought you in? What was he trying to do with you?

> **DDB:** I think he was trying to introduce more of his own background into how policy was made. I think that he was—he was an MBA in finance as I was an MBA in finance. You know, before Daniel Tarullo left the Federal Reserve Board recently, of the 17 leaders at the Fed, 10 were PhDs in economics and two were academic lawyers—none of whom had ever really seen much in the real world. Richard Fisher was on the opposite end of the spectrum to that. He started off with his MBA in finance on Wall Street, which is exactly how I started out. So, he wanted somebody to come in to translate the real world into helping him to make policy when he would go off to the Federal Open Market Committee. But trust me when I say, he was very distinct in his approach to monetary policy making and it got under a lot of his peer's skin on the FOMC.

JR: Yeah, well, you go in depth on that in the book. So why don't you just tell me, what was his relationship like with people like Janet Yellen and Bernanke before?

> **DDB:** Listen, Fisher is your—he is a perfect politician. He is perfectly polished, to kill the alliteration. So, he was always able to be diplomatic and get along with his peers in the most cordial fashion imaginable. He never had a problem with that. But by the same token, he was polite when he brought up information that flew in the face of some of their theories. But they always got along, and part of the problem is that they continue to get along. That there is not enough room for dissent, especially today when the leadership makeup of the Federal Marketing Committee, the current one, is more dovish than it's been in a generation.

JR: So ultimately, you came to the conclusion that the Fed works with obsolete academic economic models to forecast what's best for America. To what degree did that play into what happened in 2008? Because obviously, you came in already predicting this housing crisis was about to happen and look, I mean, is there any hope that this is about to change? Because we are currently going through this tightening cycle again, right now.

DDB: Well, I don't know how far through this tightening cycle we're going to get past June. The market is fully anticipating another quarter point interest rate hike, which will finally get us into something where we can say the fed funds rate is one point something as opposed to a fraction.

But beyond June, I don't know—with the auto industry rolling over, with housing looking like it's become exhausted. You've got way more buyers than sellers in the housing market, which is, in other words, that's when people perceive it being a much better selling environment than what the buyers perceive. And you've got oil prices that are stubbornly below $50 a barrel. I just don't know where the growth is going to come from in order for the Fed to continue justifying going down this tightening path.

JR: So, are we in store for another round of QE? What do you think is going to happen?

DDB: I hope not. I really, really do hope that that is not the case. That is the message being communicated in the bond market right now. The high/low maturity bond, call it the 2-year Treasury, are beginning to catch up with the yields on the 10-year Treasury. We call that a flattening of the yield curve and that is exactly what we're seeing in real time today. And that would argue for a stimulus coming down the pipeline, not tightening.

JR: So, I guess here's the biggest question. You were there. You know how these people think. I just last week, I heard a presentation by David Rosenberg from Gluskin Sheff. He went in depth as to how since 1950, I think there have been about 13 tightening cycles that the Fed has engaged in and out of those 13, 10 ended in a recession. And it's clear that we're headed for at least what looks to be a recession right now.

If they continue down this tightening path, I mean this recession, how bad is it going to get? So, you know the way they think. Do they really understand what they're heading into, the storm they're heading into?

DDB: You know, I don't know. I hear way too many Fed officials continue to say that our banks are so much stronger than they once were. Well, it's true that we don't have a bunch of toxic sub-prime mortgages sitting on bank balance sheets today. But by the same token, the Boston Federal Reserve's President Eric Rosengren has been very forthright in saying while that's true, our small and community sized banks have a ton of commercial real estate exposure on their books. We can't quantify what that's going to look like on the flip side of it because it's become, dah-dah-dah, global in nature.

So I don't know what this next recession is going to look like, but I can tell you that the financial markets should not have as much confidence in the capability of further rounds of Quantitative Easing coming to the rescue of the economy as they did during the financial crisis years when it was very much more of an experiment in policy than what is the case today. When you've got the Japanese Central Bank, the Bank of Japan, out there buying every ETF that it can find and the European Central Bank buying up investment grade corporate bonds. We're not in the same environment that we were in in 2008, headed into the next potential recession today here almost one decade later.

And you've got not just residential real estate at all-time highs, and don't even get me started on Vancouver and Toronto. But you've got, not only do you have high-end residential real estate at all-time highs, the same can be said for the bond market, the stock market, and commercial real estate globally.

JR: Yeah, in many ways, it seems like it's almost, I don't know if you would characterize this the same way, but maybe almost a perfect storm. What do you think?

DDB: Well, I mean you never know what a perfect storm is. We did not know in 2007 and 2008 what a Landesbank was. We all had to go back and get educated on what small commercial real estate firms in Germany were, because we weren't familiar with the term. So, in that sense, that's when it becomes global and systemic and you set up a daisy chain. Because the Chinese bond market is magnitudes larger than what it was ten years ago, I don't know that anybody with a straight face can tell you what's going to happen to that market, or what's going to happen to dollar denominated emerging market debt.

We just don't know where the connectivity and potential for contagion is in the current financial system and that's with things like very large Italian banks still being largely insolvent institutions. So, it's hard to say whether there's a perfect storm because we don't know where the risk lies. But we know it's not going to be pretty.

JR: Right, right. Okay, there's one wild card in all of this right now, and that's President Trump. Because obviously, on the campaign trail, he was not very complimentary of the Fed at all and he has a number of appointments to make. What do you think he's going to do? Is he going to change course and bring in a new line of thinking? Or is he just going to stick with the status quo? What's your take?

DDB: Well, I wish I could say that new was going to be the new-new, but it is patently apparent that we're as far into this administration as I ever dreamed we'd be without having a single nominee named to the now three vacancies on the Federal Reserve Board. I don't think anybody thought we'd get this far without some names being thrown out to Congress for consideration. So, the greatest worry is at this juncture, at least from my perspective, is that we're going to have more of the same. And that in fact, it could go all the way out to the far end of this intellectual spectrum in that he re-nominates Janet Yellen.

JR: Do you actually think that's possible? You think that he could, I mean, considering everything he's said?

DDB: Again, the silence is deafening. He had an opportunity on day one to name two individuals to the open vacancies on the Federal Reserve Board that would clearly communicate a message of dissent. Dissent's going to be permitted going forward, ergo, I'm just throwing two names out there. I'm throwing up John Taylor, who is famous for the Taylor Rule. I'm throwing up Kevin Warsh, who is famous for saying that Quantitative Easing is not effective. I'm just going to put those two names up immediately for Congress to consider. Low hanging fruit that would be easily confirmed. Let's get them in on the Federal Reserve Board leadership and start the spirit of dissent rolling.

And instead, we've heard—and again, those two names that I threw out were completely arbitrary. But nothing has happened. We haven't heard anything and he had a 70-minute supervised interview with the *Wall Street Journal*, supervised by our Treasury Secretary Steven Mnuchin, in which he said, "I like her, I respect her," of Janet Yellen.

So again, you start to connect the dots and you begin to worry and be concerned that his administration realizes that one of the few potential benefits to a dovish Fed will be passing legislation where it's clear that legislation is very, very much more difficult to pass than we anticipated.

JR: Well, okay, so last question for you and this predominates especially on the right side of the spectrum. You hear this a lot.

What do you say to those who say the US should end the Federal Reserve? Do they have a point?

DDB: Well, yes. They have a point and they are definitely justified in their anger, because there needs to be so much more discipline at the Fed than what there is, and the whole idea of auditing the Fed.

Look, we know that something went wrong with Medley and insider information being leaked and there definitely needs to be more accountability within the Fed. So, I sympathize with so many of the people who would rather end the Fed.

By the same token, we are the first largest economy in the world. China's the second. If we don't have any strong authoritative objective monetary policy making entity, if we don't have a strong Fed—that needs to be reinvented, mind you, it needs to be completely up ended—then I fear for our financial security on the global stage with other countries that do have greater control of their currencies. And that is why my four children take Mandarin. It's because I fear for the future of the dollar, but we have to have a strong central bank to safeguard the sanctity of the dollar, which they have not been doing by effectively facilitating this mammoth growth that we've seen in debt.

As we all know, that makes the future value of the dollar that much weaker.

JR: Well, the name of the book is *Fed Up, an Insider's Take on Why the Federal Reserve is Bad for America*. Danielle DiMartino Booth, thanks for joining me.

DDB: Thank you so much for having me. I appreciate your time.

JR: For RiskHedge Radio, I'm Jonathan Roth.

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