

Peter Boockvar – If Central Bankers get what they want, global bond markets blow up

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THE MATTERHORN INTERVIEW: Peter Boockvar – May 2016

“If the central bankers get what they want, the global bond market will blow up”

Lars Schall interviewed Peter Boockvar. Peter is one of those rare and informed people in the investment space who really understands the history and role of Central Banks in general, the Federal Reserve Bank in particular, and their interactions with the financial industry on (government) policy. We are very pleased to have Peter Boockvar on board this month with his first Matterhorn Interview. We recommend a good listen below.

[VIDEO/PODCAST] 24 mins

Transcript

Lars Schall: Howdy, ladies and gentlemen! On behalf of Matterhorn Asset Management I am now connected with Peter Boockvar, who is the Chief Market Analyst with The Lindsey Group, a macro economic and market research firm in Washington DC. – Mr. Boockvar, recently President Obama and Vice President Biden met with Federal Reserve Chairwoman Janet Yellen. It was said that in the history of the United States, it has never before taken place that both the President and Vice President met “unexpectedly” with the Federal Reserve Chair. Now, what do you believe what this was all about?

Peter Boockvar: Well, I wish I was a fly on the wall listening to the conversations between them, but I have to say that I don't think anything was too political in that. I couldn't imagine, however I could be wrong, that Obama would say to Yellen, “Don't mess this up for Hilary and don't raise rates”, and I can't imagine that Janet would say, “Okay, Barack, you got it”.

I want to believe that it was an update on the economy. I think that the White House is probably getting a little concerned that growth in the fourth quarter which printed only 1.4% is going to be followed by possibly growth in the first quarter of less than 0.5%. If you take those two quarters together, then you're looking at something that's close to flat line. The second quarter may not be looking much better and I don't think those are the circumstances that Barack Obama wants to go out on. He doesn't want to go out as a President that left his successor with a recession, and I have to believe that the White House is actually getting a bit worried about the state of the economy and the optics of it. That's why he probably met with

Yellen. Again, I don't think there's any quid pro quo on the direction of interest rates. I think that if the economy continues to muddle along at a slower and slower pace, Janet Yellen doesn't need Barack Obama to tell her that she's not going to be raising rates again any time soon.

LS: Yes, but last year, the Federal Reserve was optimistic that it could raise interest rates in a substantial way. This is now gone, this sentiment. Why so?

PB: Well, the Federal Reserve has been optimistic every year since the recession began, and every year their optimism has proven to be wrong because they're using models that no longer work. They're believing that altering the price of money lower in an already over-leveraged economy is somehow going to accelerate growth, and unfortunately haven't learned that lesson. We can be sure that the Federal Reserve will persistently be overly optimistic in the benefits of their policy.

LS: Now, if the Federal Reserve proves as unable to raise the interest rates, this is also a problem for its credibility?

PB: I believe that credibility was somewhat shot a while ago but, yes, I think that any comparison that they will then get to Japan and their policy of the past 25 years would be terrible for their credibility. I think their credibility, like I said earlier, is shot and that keeping rates at zero for seven years is... I'm trying to think of the best word to say it, ridiculous way of running policy. So, yes, and if they can't get out of the traps they put themselves in, that would definitely damage their credibility.

LS: What are your thoughts on the fact that more and more people at the Federal Reserve System are open to negative interest rates, at least they are talking about this?

PB: Yes, they see what's gone on in Europe, they see what's happened in Japan but, to me, any economist that thinks that negative interest rates is a good thing, I think needs to go back to school. Negative interest rates are essentially a tax on capital that somebody has to eat and I don't think you expand the economic pie by taxing capital. So, any Federal Reserve Member in particular who believes that negative interest rates are somehow going to be effective, to me, that's just anti-capitalist, it's anti-free market, and I actually think that they're not going to go there, to be honest.

LS: Okay, but talking about the Federal Reserve: Dartmouth College economics professor Andrew Levin—special adviser to Ben Bernanke and Janet Yellen between 2010 and 2012 when they were Fed chairman and vice chairwoman—said not so long ago, inter alia: “A lot of people would be stunned to know” the extent to which the Federal Reserve is privately owned. The Fed “should be a fully public institution” and the 12 regional banks should become fully public entities, meaning they have to somehow eliminate or repurchase the stock they have issued to private member banks. He also proposed banning anyone affiliated with financial institutions overseen by the Fed from serving as a regional Fed director. (1) Does this sound reasonable to you?

PB: I think he's overreacting. I mean, I think the problems with the Federal Reserve are much deeper than whether regional Fed institutions are more private based. The problem with the Fed is their manipulation and price fixing of interest rates. It's not the internal logistical structure of these central banks. I think he's missing the main problem of the Fed and whether these regional districts are under the Federal Reserve umbrella in being a "public institution" as opposed to having private influences. I think it is just a red herring.

LS: Does the United States and its people need the Federal Reserve actually, or do you think it is rather the case of the private banking system in and outside the United States needs this institution?

PB: Well, the institution in 1913 was created to really be the lender of last resort, and while I'm not for a government entity creating money, that's for sure, if they would have just stuck to being a lender of last resort, I think that would've been, to me, a great limit on their authority. Of course, that has not happened. They've gone well above that authority that congress particularly gave them, particularly in the late 70's when they wanted the Fed to be focused on maximum point and then price stability. To me, a most limited Federal Reserve would've been much more productive than turning them into above the law institution that they became.

LS: The next question that I have is the involvement of governments or central banks in the commodity markets because, as you know, the CME Group operates the major future markets in the United States. Its January 2014 filing with the US Securities and Exchange Commission disclosed that central banks and governments are being given volume trading discounts for trading all future contracts on the major exchanges in the United States, not just financial futures contracts – so this means they also can trade with commodities future contracts. (2) Moreover, the CME Group masters 10K filing with the US Securities and Exchange Commission for 2013 disclosed that the CME Group's customers include governments and central banks. (3) Now, let us put this in perspective to a certain statement given by former Federal Reserve Board of Governors member Kevin M. Warsh that he wrote for The Wall Street Journal in December 2011. In that essay Warsh said: "Policy makers are finding it tempting to pursue 'financial repression' – suppressing market prices that they don't like." (4) And so the question is, are central banks and/or governments players in the commodity markets?

PB: Well, I think the Fed plays in the markets that they've told us they play in, and that's treasuries, mortgage backed securities, and I don't believe that they're somehow buying S&P futures, for example, or shorting the gold market because secrets like that don't stay secrets. I happen to work for an ex-Federal Reserve Governor, and I don't think that that was something that they've done or something that they currently do.

Now, with respect to other central banks, I would not be surprised if they did but I can't say for sure. We can talk about conspiracy theories, no question, but I don't even think the Federal Reserve would call another foreign central bank and says, "We need to support a market, please get involved". I mean, we have to look at the fact that markets go up and they go down. Oil prices went to 100 then went back to 30. We had, in 2002, the

stock market fell 50%. It fell another 50% in 2007 and 2008, and the central bank of the US, the Fed, they fought it tooth and nail.

So, while we want to think that they can certainly manipulate certain markets, well, we know the ones they're directly manipulating and that works for a period of time, but I don't necessarily think that they're getting involved in these other markets because I think it would've been known and, again, I don't think they can keep a secret. I don't think anybody else in the institution would be able to keep a secret. So if it were to happen, I think it would've been known and if it did get out then their reputation would be completely in tatters. I don't think that's something they necessarily want to risk. With respect to what Kevin Warsh said, I think he was really more talking about the securities that the Fed is blatantly buying and a sense of what they've told us they're buying rather than anything else.

LS: But talking about the stock that Western central banks have in gold, they can for sure conceal the leasing that they do with this gold bullion because they are not required to say, "This is what we have and this is what we leased out".

PB: I guess it's possible, particularly with the Fed owning 8,000 tons of gold that I guess it is possible but, again, keeping that a secret, I think, would be very difficult to do and until we see proof of it, it's just pure speculation.

LS: Okay. But in the past, I've asked the US Treasury, respectively the Exchange Stabilization Fund, the Federal Reserve Board in Washington DC and the Federal Reserve Bank of New York if the Deutsche Bundesbank has gold swap arrangements with these entities, respectively if those entities have gold swap arrangements with the Bundesbank. All those entities that I've mentioned refused to answer time and again. (5) Moreover, at the end of March this year, the New York Fed President, William Dudley, refused to answer in public a question about whether the Federal Reserve is engaged in gold swaps with other central banks. (6) Why do you think they all don't like this kind of question?

PB: Maybe because they haven't yet fully disclosed it. It's possible. And we know central banks have gone above and beyond what their chartered mandates are and maybe they believe that this is just another example that they would have to explain to everybody.

LS: But couldn't they just simply lie and say, "We have nothing like this", even if they would have?

PB: I guess it's always possible but, again, I think that if they were caught lying, the damage done to the institution would be far and above any benefit that they would get from leasing out gold. To be honest, you listen to comments from Bernanke and other central banks, I honestly think that they're clueless about what gold really is. If they're clueless about what gold really is then how can I say that they're out there trying to manipulate its price?

LS: Mr. Bernanke said something in the past that gold is something like a tradition.

PB: "We own it for tradition", right. That was a response to a question from Ron Paul at a semi-annual testimony and I think that said it all about Bernanke's knowledge and history of what gold is and always has been. In that case, listening to that, I don't think he's necessarily smart enough and up to speed enough on gold to then start manipulating its price.

LS: Now, talking a little bit about the nature and value of gold. We are in the middle of a debt crisis and interestingly enough the IMF said the gold bullion, the monetary component of gold that a central bank holds, is the only financial asset without counterparty risk. Does this make gold very attractive these days?

PB: Well, there's no question because we know that there's no counterparty risk with the physical metal if you own it and you store it, I think that is an important characteristic and positive case for owning gold, but at the end of the day, the most positive thing for owning gold is that it actually yields something relative to the \$7 trillion of sovereign bonds that yield below zero. To me, that is the most important characteristic within the price of gold and will continue to be so.

LS: What are your thoughts on the German gold repatriation from New York and from London? What does this mean to you?

PB: I guess we can all speculate on the symbolism of it. Maybe it was just the Germans are more comfortable owning it on their soil rather than in the US. I don't know if that's for security purposes or just having it in their own back yard. Do I think that Germans are worried about not getting it back? If they wanted it, I don't want to necessarily go that far, but I would think that if the Germans own a lot of gold, why aren't they storing it themselves?

LS: Yes, and if you have it on your own soil, in your own possession, then it can actually have this quality as a financial asset without counterparty risk.

PB: Agreed. Now, it would be nice if the Bundesbank came out and said that instead of trying to hide why they wanted it back, but we can all assume that that's probably the case.

LS: And then we see in Eurasia, the members of the Shanghai Cooperation Organisation buying gold big time, for example, China and Russia. What do you think is the purpose to boost their gold holdings?

PB: Well, I think everyone is looking around and seeing what countries are doing to fiat currencies. Putin, for example, in Russia, I mean he knows owning a lot of gold is probably good for the Ruble, and the Chinese certainly see what their central bank is dealing with printing money, and they understand that there is a possibility they'll want to weaken the Yuan and I think the Japanese now are buying more gold and the Europeans are buying more gold. I think people are not blind to the fact that central

bankers are debasing and devaluing the worth of fiat currencies. They know that gold has been around for 5,000 years. It is a language that everyone speaks, and it is a currency that everyone accepts.

LS: What are your overall expectations for gold this year?

PB: Well, I'm of the belief that the bear market, at least in US dollar terms, that started in September 2011, and silvers bear market in dollar terms began in April 2011, that bear market is over. It was only in the context of a secular bull market that began in the early 2000's. If I'm correct then these new highs which we will see in the next coming years will surpass the previous highs, and that's around 50 bucks in silver, that's 1,900-ish in gold, and I do expect those all to be taken out within the next couple of years.

What happens from now until the end of the year, I don't know. I do think that prices continue to move higher, particularly if I'm right that the Fed is not going to raising interest rates any time soon, or likely at all through year-end and possibly not at all until the expansion after the next recession. There'll be a bid under the precious metals and where the price goes by year, and I don't know, but again in the coming years, they will most likely see their previous highs.

LS: Would you say that gold is underpriced compared to the bond markets and the equity markets?

PB: I think it's underpriced relative to the traumatic expansion and the size of central bank balance sheets.

LS: The final topic that I would like to discuss with you are the so-called Panama Papers. At CNBC, the banking whistleblower Bradley Birkenfeld said recently that the CIA is behind these Panama Papers. (7) At least this is his assumption. But there's also another interesting conspiracy theory because at the Brookings Institute, which is one of the most influential think tanks in the world, they entertained the idea that the Panama Papers represent a Putin plot. (8) What is your take?

PB: Like I said earlier with central banks, it's very hard to keep a secret. Just as Snowden did with the NSA and the Panama Papers release, in the days of digital documentation, social media and so forth, it's very hard to keep a secret. Who wanted it to come out and who had a motive to get this knowledge out there? I don't know, but it's hard to keep a secret. So whether you're the President of a major country or you're a high net worth individual that wants to hide money, just understand that a lot of people are watching and it's likely at some point they're going to find out.

LS: Do you think that there would be some kind of incentive for the CIA to do such a thing?

PB: I think every intelligence agency probably around the world is sniffing around and trying to find every trail of money. If that's what they happen to come across then I guess. The people that spend every day trying to follow the trails of money and it will take them wherever it's going to take them,

whether it's the CIA or it's intelligence agencies throughout Europe or Asia, they're on the hunt.

LS: Yes, but I think the United States has the best infrastructure for that kind of thing, like for example...

PB: I don't doubt that but I think... everyone's spying on everyone. The governments.

LS: What are your biggest concerns these days when you take a look into the world and see its problems?

PB: My concerns are the response of central banks to what's going on. Recession follows an expansion like night follows day, a bear market follows a bull market like night follows day, but the desire to suppress any cyclical growth and the desire for 2% inflation has literally wreaked havoc on global markets and global economies.

My fear is that central banks are now taking this too far through negative interest rates in particular and that they're going to literally destroy their own banking systems. If they're actually successful in generating higher inflation, then they're going to destroy their own bond markets. So, Draghi, who publically comes out and says, "I want inflation as quickly as possible". That's what he says, "as quickly as possible", but what does he think is going to happen to the German 10-year bond which is yielding 16 basis points? What does he think is going to happen to that bond if he gets inflation as quickly as possible? There is an epic global bond market that central bankers, if they get what they want, will then blow up. That's what I am most worried about.

LS: Yes. There's one more thing that I would like to ask you about. The world watches thoroughly the US these days because you have an election year. Do you think that this election will become the most interesting since decades?

PB: Yes, I think there's no question just because it's so non-conventional in the sense of it reflecting a lot of the anger that people have that Bernie Sanders has done as well as he has on the Democratic side, and how Trump has done so well on the Republican side. It's a reflection of a lot of anger in the American populous. On the Republican side they have a contested convention which we seem to be moving towards. That's a rare thing and I think that this is somewhat unprecedented in that it's not something that the country is used to.

LS: Yes. Do you think the anger is justified?

PB: I do. I think our government officials, and I will include the Federal Reserve in that, have failed the American people.

LS: Okay, thank you very much for this interview.

PB: Okay, thank you.

Peter Boockvar is Managing Director and Chief Market Analyst of The Lindsey Group,

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