***** PLEASE NOTE THAT THIS TRANSCRIPT DOES NOT INCLUDE THE PRE-INTRO, AND THEREFORE, EVERYTHING IS SHIFTED UP BY 47 SECONDS. PLEASE KEEP THIS IN MIND WHEN SEARCHING THROUGH THE TRANSCRIPT**

Demetri Kofinas:	00:00	What's up, everybody. My guest today is Jim Grant. Jim is the founder of Grant's Interest Rate Observer, a twice monthly journal of the financial markets. He is also the author of several books, including his most recent, Bagehot: The Life and Times of the Greatest Victorian, a biography of the brilliant and influential English banker, economic and political writer and editor of the economist whose ideas about central banking informed the US Federal Reserve's response to the global financial crisis.
Demetri Kofinas:	00:38	Jim, welcome to Hidden Forces.
Jim Grant:	00:42	Well, thank you. I hardly recognized myself for a moment.
Demetri Kofinas:	00:45	How are you?
Jim Grant:	00:46	Good, thank you. I'm well.
Demetri Kofinas:	00:47	You look fantastic. I told you, you look fantastic, lively, vibrant.
Jim Grant:	00:52	As the listeners can see.
Demetri Kofinas:	00:53	As they can see [Nodding] . You have a vibrant bow tie as well today. It's more colorful than--
Jim Grant:	00:57	I do. I read in the Wall Street Journal that some people find bow ties to be an affectation.
Demetri Kofinas:	01:03	So, I tweeted out. You know, people love you and I think you're aware of this, though I don't know to the extent that you're aware of the fan club, and I tweeted on social media that I was going to have you on the program, and I asked suggestions for questions. And one of the questions was, "Ask him why the bow tie."
Jim Grant:	01:19	Right. What was the second-best question?
Demetri Kofinas:	01:22	The second best question was, "What is he invested in personally?" I was going to tell him, "Gold and New York Athletic Club bags."
Jim Grant:	01:27	Right. Right. Yeah. Well, the bow tie, my father asked the same question. I was seen on television with a bow tie many years ago, and my late father said, "Do you think that you're Dave Garroway?" Now, this is a cultural reference that will not be at the front of everyone's mind. Dave Garroway was a TV personality in the 1950s. Not 1850s Demetri, 1950s. And he looked good in it. Yeah, he did.
Demetri Kofinas:	01:52	But did you like it? Did you feel that he gave you a certain gravitas or seriousness so you didn't have to worry about that?

Jim Grant:	01:58	Oh, I don't know.
Demetri Kofinas:	01:58	You just liked it.
Jim Grant:	01:59	I liked it.
Demetri Kofinas:	01:59	It's buttoned up.
Jim Grant:	02:01	Yeah. I like my darn bow tie, Demetri. That's it.
Demetri Kofinas:	02:03	I like it too. It's such a big part of who you are.
Jim Grant:	02:05	Yes. The FT, Financial Times has this irksome feature in the magazine, which is also annoying. It's called "How to Spend It." This is from this lefty publication that is editorializing against all sorts of excesses in the private economy. So, "How to Spend" is the name of this publication, and they have a weekly section when this thing appears, and the section is called ... Now, what's it called? Anyway, it's a feature of some aesthete. It might be the Aesthete of the Month, for all I remember. And they always ask, what is your style signifier? And I was hoping, Demetri, that you might ask me what my style signifier is.
Demetri Kofinas:	02:46	And I think I did, didn't I?
Jim Grant:	02:47	Yeah, it's my bow tie. Yeah.
Demetri Kofinas:	02:48	Yeah, it's your bow tie. Yeah, I would have guessed that. So maybe we can, in the future, I'd love to, because I think I had actually emailed you about this months ago.
Jim Grant:	02:58	Did I ghost you?
Demetri Kofinas:	02:58	Probably, forgot to respond, but no, the point had to do with Bagehot and maybe devoting an episode to him, but tell us a little bit about this book and who Walter Bagehot was.
Jim Grant:	03:10	Yeah. Well, Walter Bagehot was a most extraordinary character. He wrote wonderful prose. And he did it with the job title of financial journalist. Now, financial journalism is not the most elevated ... Now, how do I say this? If you, Demetri, find yourself at the pinnacle of financial journalism, you are still standing at sea level. That's the way it works in financial journalism. So, it's a somewhat ordinary branch of the journalistic trades, but Bagehot not only in his main line of work, which was writing about markets and about the political aspects of market, quite apart from that, he was a wonderful writer of biographical profiles and literary criticisms. He wrote things on William Shakespeare. He wrote things on John Milton. He wrote a great essay on, you name the political figure and he probably wrote one about that figure, such as William E. Gladstone, the long serving prime minister in Victoria in England.
Jim Grant:	04:14	So he was a most gifted writer, and what he wrote about in the financial way were things that today resonate as sharply and as controversially as they did in his day. One of the great questions in finance is what's money and who says so?

		Right? Another question is what business do people with large sums of money have in asking for favors from the government of all the people? For example, if you are at the head of a very large financial institution and use zig when you should have zagged, and there is a thunderclap in the stock market and you find yourself a little short of cash, are you then allowed to go to the Federal Reserve and say, "I would like six or eight truckloads of hundred-dollar bills." And they say, "Certainly, sir. What address may we deliver?"
Demetri Kofinas:	05:06	There's been a lot of zigging lately.
Jim Grant:	05:09	Yeah. Right. And the third issue that was suggested is, that is as controversial and as inclined to argument as it was in Bagehot's time was say if a firm gets into trouble, shouldn't the stockholders be responsible for making things, right? This is a little bit related to the other one about whether the firms have a right to go to the Central Bank. But in Bagehot's time, every firm was, well, to start with a general partnership, meaning that the partners, the owners of the firm were responsible personally for the debts of the firm or the pro rata share. So, if there was a run on the bank and the bank became insolvent or impaired, there was a capital call to the owners and not to the stockholders, which I so admire that. I think it's a great way to do business. Right? Personal responsibility.
Jim Grant:	06:03	So is there collective responsibility or personal responsibility? Is money the thing that is so designated by the government, or is it something that's social evolves? These fundamental questions actually have not changed much, nor have the answers. Well, the answers have. The answers have.
Demetri Kofinas:	06:21	I can guess where you fall on that.
Jim Grant:	06:22	Yeah. But listeners, note that he is staring at my bow tie as he says that.
Demetri Kofinas:	06:28	So the other question that they mentioned, maybe we'll get to it, the reason I said, "Gold and the New York Athletic Club bag," is because either you had told me this once in a story, or I had read it in one of the issues of Grants years ago where you talked about walking home and you had forgotten or you had still some gold-"
Jim Grant:	06:45	Oh yeah. I can confess this. The Julia Child had a three second rule of dropping it in the floor, it's okay if you pick up. So, if enough years have elapsed since a very embarrassing and self-revealing financial mistake, it's fine. Right?
Demetri Kofinas:	06:58	It is.
Jim Grant:	06:59	Okay. So, years ago I started buying Krugerrands, which are these one-ounce gold coins, come from South Africa. And one of the first purchases was in the summer. I had 25 of these things, which was $25,000 was for me then really a lot of money. Now it's still a lot of money. Who wouldn't stop on the street, Demetri, and pick up $25,000 lying there?
Demetri Kofinas:	07:24	I would.
Jim Grant:	07:25	Almost everybody on this podcast would do that.

Demetri Kofinas:	07:27	Unless it was gold, maybe they wouldn't. There is that funny video on YouTube. I don't know if you've seen it [laughter 00:07:33].
Jim Grant:	07:32	Yeah. Right. Who needs that stuff?
Jim Grant:	07:35	Anyway, well, this is the point of the story. So, this was, I don't know, nineteen ... was it ... hold on a second. That must've been in the early or mid 1990s. Nobody cared about gold.
Jim Grant:	07:48	So I went to the place to buy it and I came back with it and it was in a Grant's canvas bag. We give these things away at our conferences. Actually, we don't give them away. They come and pay a lot of money and they get one for this part of the price.
Jim Grant:	07:59	Okay. So, I had it in mind to carry this gold home on the subway, and I realized at about two in the morning I had not done that. I left it stacked on the desk. Now, fortunately my desk is rather like a police crime scene. It's not exactly what [crosstalk 00:08:16]-
Demetri Kofinas:	08:16	... they might have thought it was a paperweight.
Jim Grant:	08:17	Yeah. So, I was thinking, "It'll probably be there in the morning." And I thought about that for the next five hours. And sure enough, it was there. And I realized that because gold, whatever year it was, it might have been 1998, which I think the nadir of the gold price, which is like 200 and something dollars an ounce, and it looked like hardware, so it was safe.
Demetri Kofinas:	08:39	Exactly. No pun intended.
Demetri Kofinas:	08:42	So there are so many things that I want to talk to you about. I did a lot of work ahead of this conversation trying to prepare. A lot of it was just spent as, I think I told you, or maybe I told Eric this or Evan, I don't remember who. I talk to so many people at Grants. I love Grants and I've told my listeners this. And I've been to your conferences. Love them. Some of the best guests that I've ever had on the program I've met through the conferences.
Jim Grant:	09:07	No, terrific. I'm glad to hear that.
Demetri Kofinas:	09:09	Yeah. Like Christopher Cole came on our capital account years ago in 2012. Had presented in the fall at Grants. It's a great conference. Your stuff is the best. And I spent a lot of time going through Fed minutes, and the first thing I spent a lot of time on, because with the program we don't focus on just markets. We do all sorts of stuff. So, whenever I do an episode like this, it's an opportunity for me to delve into things. And we didn't have a chance to get to talk about what happened in the repo market in September. And so, I spent a lot of time doing that, both reading through minutes, but also looking at official and unofficial explanations for what happened. Maybe you can fill in our listeners, I mean some people will already know obviously, but I'm sure they'd love to hear from you.

Jim Grant:	09:50	Well, this is a very inside baseball thing that is nonetheless very something like universal interest because it involves, again, these big questions about Wall Street's legitimate call on the resources of the entire government, which we all have an interest, right? Most of us certainly contribute to [crosstalk 00:10:11]-
Demetri Kofinas:	10:11	And they have been deploying those resources.
Jim Grant:	10:13	Right. So, first of all, repo is a short word for repurchase, and a repurchase agreement is a collateralized loan, meaning a loan that is secured by something except the borrower's pledge to pay it. If I borrow five bucks from you, say I'll give it to you next week, that's fine. But if I give you $1 million, I expect you to sign something or at least pledge to you, Demetri, I can have one-tenth interest in your mansion that'll satisfy the million dollars.
Jim Grant:	10:44	So, these are collateralized loans, and collateralized by Treasury securities, by the bills, bonds and notes the Treasury issues to finance the deficit. All right, so this is a relatively commonplace transaction on Wall Street, but what was not commonplace, it was quite out of the ordinary in the middle of September, was that the interest rate that people demanded to lend against the presumably unquestioned solidity of these bills, notes, and bonds, the interest rate suddenly got to 10%. Now, who earns 10% on a savings account or anything except like Argentine bond? 10% is an extraordinary, it's a usurious rate these days. It is unnatural.
Jim Grant:	11:29	So how do they get there? Well, it got there for reasons that people can guess about. One of those reasons is that in the wake of the great financial crisis, the government enacted all sorts of regulations that make markets less resilient, that tell you what you can and cannot do with your money or with your depositors' money, that make things instead of responsive, rather rigid, or like the word of art in Wall Street, they silo money. So, they say you have to have this much set aside in high quality liquid assets.
Demetri Kofinas:	12:03	Liquidity coverage ratios, for example.
Jim Grant:	12:05	Liquidity means just what it sounds like. And it was like as water flows, so should money. So, these rules, well-intended I suppose as they were, have backfired in their unintended consequences as so many rules do. And so, JP Morgan had plenty of money they might have lent, but to do so would have perhaps provoked the resentment or the suspicion of the regulators who live on the premises and actually work side by side with the bankers. That's how closely these institutions are regulated.
Demetri Kofinas:	12:38	So you're saying that JP Morgan needed to have a certain amount in liquid reserves?
Jim Grant:	12:44	Yeah. They've held more or less ... fallow is the farmer word, keep a corn field fallow for a year or two by planting hay on it or something instead of corn just to ... But anyway, it's money on ice. It is not usable. It is inert.
Demetri Kofinas:	12:57	Thought that doesn't explain the why they wouldn't have been able to borrow at a lower rate elsewhere and redeploy the capital.

Jim Grant:	13:02	Correct. Correct. That explanation is quite common. You hear it quite commonly, but it's not necessarily persuasive. Right? Okay. So, I don't know why 10%, but what I think gets us closer to the answer is why that rate has remained, if not elevated every day, why the market has required constant intervention by the Fed to prevent it from rising above the target ref. I forget what the target rate is, like two something percent, the very low rate.
Jim Grant:	13:30	So why must the Fed be in there week after week, almost day after day, not quite day after day, but certainly week after week, injecting sums which cumulate to the most extraordinary figures like $6 trillion.
Demetri Kofinas:	13:42	Since, September ...
Jim Grant:	13:44	These are recurring. They didn't create $6 trillion to do this. They used a billion over and over again.
Demetri Kofinas:	13:52	Yeah. These are overnight repos and also 30 day ...
Jim Grant:	13:55	Right. These are short term loans secured by the aforementioned treasury securities. So okay, so here's the punch line. What we think is the problem is simply that at long last this great big deficit that appears to have been of absolutely no account in practical finance and is now becoming like, as I say, a thing. And let me explain if I may ...
Demetri Kofinas:	14:20	When you say this deficit what are you referring to?
Jim Grant:	14:23	The federal deficit, the federal deficit. Let's take it in gross terms when we're not going to get cute and take out what the social security trust fund and ... this is not just debt held by public investors, but the whole shooting match. Wherever it is in the ledgers of the world, the gross obligations of the federal government.
Jim Grant:	14:42	So, as we all know, the deficits have gotten bigger and therefore the debt has piled higher. We know this, but we also know that it has made no visible difference in our financial lives because mortgage rates have scarcely ever been lower, well as much VIG to get a car loan as it ever did, but that's for our purposes neither here nor there exactly. But mostly rates are extremely ... Oh, the state of New York, which is kind of okay financially as a rhetorical courtesy, gets to borrow 2.5%. So, rates are low. So, people will say, "Well, deficits don't matter."
Jim Grant:	15:20	1981, Ronald Reagan appears before the TV cameras and says to the nation ... this is by the way when bond yields were like 15%, one, five. Okay, so Reagan says, "We have a debt of $1 trillion." It just crossed the trillion. Now we've gone from nothing in 1789, let's say it was nothing in 178 ... it was not nothing, but it was sensibly little in 1789, the Constitutional Convention, so from nothing into $1 trillion from 1789 to 2001. Today that debt is 23 trillion and the debt has increased since August by one trillion.
Demetri Kofinas:	16:06	Well, that's the nature of debt accumulation. It's exponential.

Jim Grant:	16:14	Well, this would certainly look like something that is more than just been a bad habit. Well "bad" might not be the word, but anyway, so it goes from one trillion to 23 trillion and the rate of acceleration is accelerating. So, it doesn't matter? Maybe it matters, and maybe the proof of that consequence is that it takes the government's main force to suppress the rate at which you borrow to finance these things. That rate wants to move up, it's being held down by the Fed and its mighty interventions. So, I think that this could be the leading edge of the deficit becoming a phenomenon of practical financial consequences as opposed to abstract political worry.
Demetri Kofinas:	17:04	So this has been a central point of debate, which is are borrowing costs low for the government because the Fed is ...
Jim Grant:	17:13	Put them there.
Demetri Kofinas:	17:15	... put them there, or is putting them there actively, because you could argue that the Fed in some ways contributed to putting them there with its accommodative monetary policy during the boom years. Or are rates low for the government because people perceive it as the risk off alternative in an otherwise very risky market? And you have come down on the side of it being the Fed actively keeping rates low for some time now.
Jim Grant:	17:42	Yes. I respect the other side of the argument. Some very smart people make it. What they say is that after every financial debacle on the scale of 2008, '9, or even something not quite so severe, that there was a period of ... what's the term in social life? Katzenjammer I think is the word that's sometimes used to describe the aftermath of a big party. So, there is a period of remorse and of aching heads, and this takes the form, in finance, of very low interest rates and very quiet and tentative activity. "Shhh, don't talk too loud. Your father had a big night."
Jim Grant:	18:18	Okay. So that's typical cyclical behavior. After a crash, there is a thud and then a period of stillness and very low interest rates. That's the book, right? All right. That's the form. But it's been 10 years. And why I think that the central banks have been instrumental in keeping rates as low as they have been, is because rates have never been lower in the 3000 or 4000 years of recorded interest rate history. I think that's a pretty good inferential piece of evidence that somebody is doing something new. And look no farther than Europe and to the interest rates prevailing there. They're worldwide, much in Europe, some in Japan about, I don't know, something like $11 trillion worth of bonds. IOUs are priced to deliver a yield to the lender of less than zero. Isn't this wacky?
Jim Grant:	19:18	So you want to lend to the government of Germany, you pay the government of Germany for the privilege of them accepting your money, and rather than they paying you, you pay them? Yes. That's the way it works. That's a new, new thing. And for pedants listening, yes, there was some of this in short term treasury bills in this country in the late '30s, early '40s, yes, true. But nothing on the scale that is present today, nor was it ever prevalent in longer dated securities, not just treasury bills.

Jim Grant:	19:53	So the downward suppression of interest rates in Japan and in Europe has naturally had its effect here as well, because the world was one big marketplace. Right? So, should we say it's really interesting. My publication is called Interest Rate observer. And what I observe is something historic.
Demetri Kofinas:	20:15	And you've been observing it for a while. The last time-
Jim Grant:	20:17	We just started volume 38 number one, and can you believe it? I am, what? 45? 50 tops, right?
Demetri Kofinas:	20:24	Tops, tops. Last time you were on the program, you were on episode 13, that was the last time you were on the show. And we talked about how there are kids that are growing up today that have never seen an interest rate.
Jim Grant:	20:36	God, what they've missed. But you should've seen them, people. They were something.
Demetri Kofinas:	20:41	They were lucrative and they were alive. They were there. You could see them. You've called them all sorts of things, I think microscopic interest rates ... But this is something that you have been talking about, of course, and so many other people have been talking about and thinking about and just it's to a point where you've gotten tired of thinking about it.
Jim Grant:	21:01	Well, people have gotten tired of hearing about it, that's for sure.
Demetri Kofinas:	21:03	Yeah. I'll tell you how I feel about all of this because the larger point that you're getting to, and we didn't mention this when we were talking about the repo market. Yes, they have the $6 trillion number is in these recurring repos. That's not permanent money, but the balance sheet's been expanding. That's a huge thing.
Jim Grant:	21:24	Now, let's back up a little bit and say what a balance sheet is and why in the case of the Federal Reserve-
Demetri Kofinas:	21:29	You're getting. You're teaching people some things they never heard before, interest rates and balance sheets.
Jim Grant:	21:33	Well, no, I mean people fling these terms around as if, oh yes, it's like you read a sports page and now you've got to figure out what WAR is: Win Above Replacement Value. Well, it is just what it is.
Jim Grant:	21:44	All right, so balance sheet simply gives your assets and liabilities, what you owe and what you own, and the Fed owes, in a way, the value attached to the Federal Reserve notes that some of us are fortunate enough to have in our wallets.
Demetri Kofinas:	22:01	That's the liability on the Fed's balance sheet. It's the value of the Federal Reserve notes that it issues in return for US treasuries.
Jim Grant:	22:08	Right. And the treasures are the assets.

Demetri Kofinas:	22:10	And just for listeners who aren't familiar, when we talk about the repo market or the interbank lending market, that is the market in which the Federal Reserve operates as well. So, when banks are going into that market to borrow money, the Fed is also active in that market through its open market desk, but continue. We should get into some of those details.
Jim Grant:	22:27	Right. Not too many. They can be.
Demetri Kofinas:	22:30	What's interesting is how that market has changed since IOER, since October of 2008 when the Fed moved from a corridor to a floor system. And that I think is something that we should talk about but go ahead.
Jim Grant:	22:40	IOER. Yes. Well, ladies and gentlemen, apart from interest on excess reserves, as Demetri was saying, so the Fed's balance sheet is a reflection of the *oomph* with which it injects credit into our lives, into the banking system and it may or may not get from the banking system to each of every one of us, but it shows you the Fed's intentions. In the past three months, the Fed has the measured oomph, strength of the Fed's credit impulse is like an annual rate of 35%, which is wild. And so, the stock market goes up, it doesn't go up necessarily only because the Fed is handing it out hand over fist, but that doesn't hurt.
Demetri Kofinas:	23:30	Well, it's erased this entire balance sheet unwind from November 2018.
Jim Grant:	23:35	Yes it has. Yeah.
Demetri Kofinas:	23:35	A full year.
Jim Grant:	23:36	So year over year, the Fed's balance sheet is growing at one point something percent, but over six months it has been growing in annualized, I don't know, 15% or something by memory. But I do remember vividly the latest three months, annual rate 35%. It's accelerating.
Demetri Kofinas:	23:50	So before the crisis, the balance sheet was just under a trillion dollars, right? It was like 800 or ...
Jim Grant:	23:54	Yeah, right. 890 or something, 900.
Demetri Kofinas:	23:56	Something like that. They touched somewhere between 3.8 and 3.7 trillion before they started to increase the balance sheet again now, since this repo madness. What can we infer from that? Again, this brings us back to the question because some of the other theories, the less official theories that I've read don't explain this simply on account of let's say treasury issuance or tax payments or liquidity coverage ratios. There are some alternative explanations. But what are we to infer from-
Jim Grant:	24:30	But wait a second, wait a second. You know something, what is it?
Demetri Kofinas:	24:30	Well, one of the things that I wasn't aware of is that non-banks like hedge funds use the interbank market to speculate. And some of the stuff that I read suggested that maybe some of these larger commercial banks were unwilling to participate because they wanted the Federal Reserve to increase the amount of

reserves in the system in order to make credit more accommodative for some of these other players in the marketplace.

Jim Grant:	24:57	I don't know, maybe, but certainly if that was the intention, they've achieved the shadow way they have achieved their wish because the Fed is now in their seemingly to stay. I'm not sure how long it'll go on, but the Fed is in there with main force and ... anyway.
Demetri Kofinas:	25:14	Well, I mean these banks, for example, like JP Morgan who you brought up earlier, their executives are remunerated in bank stock. Their corporate share buybacks are a big part of what we see now on Wall Street. They benefit from their stocks continuing to rise. So, there's a lot of incentive in the market for a lot of these actors to continue to see prices continue to rise. Right?
Jim Grant:	25:39	Well, I mean I think that's saying nothing more than people love a bull market. Everyone on Wall Street, is more or less everyone, except for the renegade minority that sells stocks short. Everyone does better in a bull market. I don't think there's anything new.
Demetri Kofinas:	25:51	So you think the banal explanations that this is a regulatory issue, it's also perhaps ... This brings us back to the point about IOER, that this market, even though it was always manipulated or has been manipulated since the Fed began operating its open market desk, that the price signal within the interbank market was meaningful.
Jim Grant:	26:13	Right. Well, this is a great point, Demetri. There was something in the day called the London Interbank Offered Rate, known as LIBOR, "lie" meaning "untruth," and "bore" meaning tedious. That's the denotation of LIBOR.
Demetri Kofinas:	26:30	I've never heard that one before.
Jim Grant:	26:31	Otherwise it's called London Interbank ... So, the London rate was the rate that the big bank lenders and borrowers negotiate among themselves to determine the clearing rate for short term money. And it wasn't exactly discovered, in the market we say to "a price discovered." "Discovered," I think, is a great term. It means that a price is the result of buyers and sellers testing each other and deciding what's the right price.
Demetri Kofinas:	26:55	This is also, by the way, not LIBOR, but the repo market that we're talking about here, this is part of the larger money markets that were royal during the 2008 financial crisis.
Jim Grant:	27:03	Sure. So, before the crisis to generalize kind of heroically, rates were discovered. Since then, they have been increasingly administered. So, the Fed's new pat rate, supplanting LIBOR and really supplanting the Federal Funds Rate. It's called SOFR, Secured Overnight Repo Rate or something. A friend of mine calls it new Coke, and it's a dubious improvement on the predecessor.
Jim Grant:	27:29	But anyway, all these acronyms and all that stuff, it's a little bit confusing, but the point of bear in mind is that the market has been taken more and more away from price discovery and more and more toward price manipulation and

administration. And what's wrong with that is that they, the manipulators and administrators, don't necessarily know what the right price is.

Jim Grant: 27:53 So let me back up to the historical origins of the Fed for just like 90 seconds. So, the Fed came into the world 1913, 1914 to provide seasonal assistance for commerce, particularly for the movement of crops during the autumn when typically, there was a shortage of cash and rates would spike and crises would fester. That was seasonal credit assistance for commerce. That was the idea. So now it is year-round assistance for the Federal Reserve for the federal government to finance this burgeoning stupendous debt. And so, the possible meaning of, if I'm right about ... if we, because I'm not alone at Grants, are right about this, right that is that the weight of the debt is now beginning to tell in the financial markets, it's a very big thing.

Demetri Kofinas: 28:48 And you're saying that what we saw in September was partly a result of the budget deficit?

Jim Grant: 28:52 Partly. There was a confluence. You mentioned tax payment data. There was a corporate PAC tax payment, but everyone saw that coming. I mean, every time I am asked to recite the reasons why this happened, I duly recite it. It doesn't make any sense.

Demetri Kofinas: 29:06 So you think this is one of the first rumblings?

Jim Grant: 29:09 I think it's one of the first rumblings of the deficit beginning to count in a way that matters in Wall Street. And if I'm right about interest rates being unnaturally suppressed rather than naturally low, the implication of that would be that rates are going to go up.

Demetri Kofinas: 29:26 But surely it can't be that let's say JP Morgan or Goldman Sachs wasn't willing to lend to the government at 8%.

Jim Grant: 29:36 No. People were willing to lend, but they felt constrained against lending by some of these regulations. That much I think is certain. That much is certain. But you, many moments ago, you said, "Well why wouldn't others ..." there's all sorts of lending outside the banking system, right? All these direct lending operate ... Why didn't somebody come in? Well, I think this is what you get with heightened regulation, is you get to barriers the free flow of goods and services and money.

Demetri Kofinas: 30:04 Bring that back to me to the federal deficit because I'm not following you. How does [crosstalk 00:30:09]-

Jim Grant: 30:08 Because repo rate is the rate charged for lending against treasuries. And if there are too many treasuries, there'd be too much demand and the interest rate would go up. Right?

Demetri Kofinas: 30:19 Mm-hmm (affirmative). So that's your larger point. Your point is that rates are a beach ball, they're underwater. You're not identifying exactly how far they should go, but the point is they're suppressed and that what we saw there was the hand being taken off the ball.

Jim Grant:	30:36	Well, the hand is still on the ball, but the tell is that the hand is putting more and more pressure to keep the ball beneath the surface, and that that pressure is measured in the amount of resources the Fed devotes to holding the rate down.
Demetri Kofinas:	30:50	Now, you mentioned there are other people that have taken the opposite side of this trade, people like Gary Shilling, for example-
Jim Grant:	30:56	Sure, Lacy Hunt. Van Hoisington.
Demetri Kofinas:	30:58	Exactly. Lacy Hunt. Both have been on this program. What makes you feel that they're wrong and you are more likely correct?
Jim Grant:	31:07	Because it's my turn. It's my turn to be right, Demetri.
Demetri Kofinas:	31:09	It is, totally is. It totally is. It's been a long time on this one.
Jim Grant:	31:15	Fair is fair. Because I don't know, I may be wrong, but no one profitable idea is forever profitable. Right? Things work in cycle.
Demetri Kofinas:	31:26	But in the late '90s, maybe it started in '98 I wasn't woke during this period. I mean I was in high school, but I wasn't really-
Jim Grant:	31:34	Are you woke now?
Demetri Kofinas:	31:35	I'm more woke to the market is my point. But I think it was '98 or maybe '99 when people started using the term "new paradigm economy" in a way to justify the valuations that they were seeing.
Jim Grant:	31:49	Oh, sure. Yeah. That's standard procedure from the dawn of markets. There's always a rationale for-
Demetri Kofinas:	31:53	I see. I'm thinking to myself lately, are we in a new paradigm where we have to really take into account the federal government, that the new paradigm is that the Fed genuinely will not, and that if it's not willing to, that that's enough, allow these markets to correct because they need asset prices to be high? Irrespective of what's happening in the real economy, that they are committed to dousing this market and preventing any kind of deflation, and that therefore betting against the market or against inflation by thinking in terms of traditional valuation models is no longer accurate.
Jim Grant:	32:36	Like it's a new era, right?
Demetri Kofinas:	32:37	Yeah. A new paradigm.
Jim Grant:	32:39	"New era" is the phrase to [crosstalk 00:32:41]-
Demetri Kofinas:	32:40	New era, is that what people are using today?
Jim Grant:	32:43	Yeah. That was what they used in 1929.

Demetri Kofinas:	32:44	Oh, 1929.
Jim Grant:	32:46	Well, there's always a new era, right, every 10, 12 years, nothing mechanical about these things. Otherwise people would catch on.
Demetri Kofinas:	32:52	But you can see it in the minutes. I mean they've changed entirely the way they ...
Jim Grant:	32:57	Sure. Now that they want inflation, and this taste getting used to, if you're a gentleman of a certain age, they want it, and of course they believe they can control things.
Jim Grant:	33:06	Let's get back just ever so briefly to this deficit question and federal debt matters. There's a very now increasingly established, certainly almost mainstream school of thought called modern monetary theory, which holds that no such thing as sound finance, there's only functional finance. What works is what's functional, is what's right. Bernie Sanders is a well-known advocate of this on the stump. And it holds that government should borrow as much as it wants to, the Fed should print as much as it needs to until such time as there is visible inflation, not on Wall Street but at the checkout counter. And until that time, and just go for it. And when the reckoning does arrive, just tax people with money. That's the approach [crosstalk 00:33:54]. Abba Lerner promoted this. Don't laugh. Abba Lerner was a formidable intellect. He was, in his stuff. Go online and read some of his essays. He's sometimes overly technical, but much of it is not, and Keynes read this stuff and said, "Wow, that's really good." God help us if it ever goes into practice.
Jim Grant:	34:12	But what Lerner also said is that is that a government can do this if it owes its debt at home to domestic borrowers. We, of course, owe a great percentage of our debt to overseas creditors.
Demetri Kofinas:	34:24	But also the idea that you would go from the current model of managing, well, we've diverged from this corridor to a floor system, but if we just take what we had in 2008, go from this model where the Fed is active in the repo market to a place where in order to put a cap on inflation, the Fed needs to tax, it's a much less responsive mechanism for it.
Jim Grant:	34:47	Well, is Congress going to enact a tax hike when things get out of hand?
Demetri Kofinas:	34:50	How's that going to work? That doesn't make any sense.
Jim Grant:	34:53	I know it doesn't. I just want to let the listeners know that I wasn't born yesterday. I'm in touch with modern monetary theory too, just like the kids.
Demetri Kofinas:	35:01	You've written about it. You've also spoken about it, and I didn't mention this at the top, I should have, you are the host also of Grants of the Air? What is the official name of the podcast?
Jim Grant:	35:14	Yeah. Everyone's got a podcast, Demetri.
Demetri Kofinas:	35:15	Well, yours has now been running almost three years and it's very successful.

Jim Grant:	35:17	It's called The Current Yield.
Demetri Kofinas:	35:19	Current Yield.
Jim Grant:	35:19	Yeah, yeah.
Demetri Kofinas:	35:20	But it's also, you say it has beautiful ... what era is that music from?
Jim Grant:	35:24	Oh, that's Count Basie, April in Paris in 1955, which happens to be the year the Dodgers won the World Series. The Brooklyn Dodgers won the World Series.
Demetri Kofinas:	35:32	That was the last year that they won the World Series?
Jim Grant:	35:33	The only year in Brooklyn.
Demetri Kofinas:	35:35	When did they leave Brooklyn?
Jim Grant:	35:36	1958. And I'm getting over that now, a little.
Demetri Kofinas:	35:40	So just to say, though, it's great. It's a fantastic podcast. You're so much fun. It's a lot of fun. And you really take as Ricky Gervais would say or any Brit, you take the piss when it comes to Eric and his vacations to all sorts of dangerous retreats. I told him, last time I spoke to him, I said, "So Eric, where were you this time?" And he goes, "No, no, no, no, no." He didn't even want to talk about it. He's been so traumatized by the experience. But people will have to listen to know what that is.
Demetri Kofinas:	36:11	So we can move away from the mechanics a bit and we've talked about the deficit and we talked about treasuries. You have been bearish on treasuries for a while and you continue to be. But so far, treasures have been, as Gary Shilling will tell you, a phenomenal investment long term.
Jim Grant:	36:29	What I meant to say was yes, Gary is correct. I didn't mean to say ...
Demetri Kofinas:	36:37	But one of the things that we can perceive, though it's-
Jim Grant:	36:40	A treasury bond is a promise to pay in a currency that is undefined and is expandable at the whim of the Central Bank. That's the nature of the beast. So, that's seemingly not a very good thing because the body that owes the money, the Treasury, also is in charge through the Fed and the two are related, let's not forget, in charge of creating the value that the money embodies. They are in charge of either making money scarcer and more valuable, or more plentiful and less valuable. So that's a conflict of interest, right? So that conflict of interest is not very important when treasuries yield 8%, 9%, 10% above the rate of inflation. That's a pretty good deal, right? As it was some time ago. But when treasuries yield something less than the rate of inflation, is this such a great investment? It has been a great investment. That's different from "is a great investment."

Demetri Kofinas:	37:43	Yes. So, one of the major effects of all of this is, and you alluded to it earlier, if not said it explicitly, is the distortion of prices everywhere in the economy and also risk taking and the perception of risk. We've seen this in venture, we've seen this in leverage loans, these are things that you've written about extensively over a long period of time, and we've seen it in the valuation of assets and stocks and everything else.
Jim Grant:	38:08	And venture capital, Uber wouldn't be around except for, I mean ...
Demetri Kofinas:	38:13	SoftBank, the behemoth-
Jim Grant:	38:14	Yeah, yeah. WeWork, too bad. Yeah. Yes. So, Walter Bagehot, my hero, alluding to the national symbol of Great Britain said, John Bull can stand anything, but he can't stand 2%, meaning that very low rates of interest instigate specular behavior that ends in tears. That was true then. It's true now, but Bagehot meant positive 2%.
Demetri Kofinas:	38:37	Exactly. Not negative 2%.
Jim Grant:	38:40	So low rates, big trouble. That's the age-old rule, and very low rates, very big trouble. And we'll see.
Demetri Kofinas:	38:48	So let's talk a little bit about, like I said, you've written about this, you've written about what I've called here, the unicorn industrial complex, not your words.
Jim Grant:	38:56	That's pretty good.
Demetri Kofinas:	38:56	Yeah, it should be ...
Jim Grant:	38:59	That's very good, Demetri. In fact, I almost think I said that.
Demetri Kofinas:	39:01	Did you?
Jim Grant:	39:02	Well, just now I did. Yeah.
Demetri Kofinas:	39:05	You might have. And you see here, I have these pictures here. There's a unicorn here. I won't bore you with that one. This is definitely not you because this guy's wearing a-
Jim Grant:	39:12	Remember the Thurber parables Fables for Our Time? And that unicorn was ... a unicorn is a mythical beast. It turns out it's not. Unicorn is ...
Demetri Kofinas:	39:20	They exist. They exist in Silicon Valley. So, this is a woman flattering herself in the mirror. This is a thinning mirror you can see here, and one of the things that we've really seen is enormous valuations for companies that have tapped credit markets in place of profits. And in some of the most extreme cases that we've seen have been in the case of like WeWork where they just couldn't even get the IPO off the ground and their founder walked away with over $1 billion after not making a profit.

Jim Grant:	39:49	Oh, man's got to eat.
Demetri Kofinas:	39:49	And it's pretty remarkable if you think about it, because the money he made was money he raised, right?
Jim Grant:	39:54	Correct.
Demetri Kofinas:	39:55	So it's a remarkable thing.
Jim Grant:	39:57	It is remarkable. And then you find these examples all over the place. You find a real estate brokerage firm in New York called Compass, which is VC funded, venture capital funded-
Demetri Kofinas:	40:09	Also backed by SoftBank.
Jim Grant:	40:12	I think so. Anyway, the people that compete with Compass just can't believe. How do they do that? How do they pay these salaries? How do they pay this proportion of commissions? Well, they do it is indirectly through the credit environment, through easy money, through free money. That's how these structures come to be. But sooner or later they have to do something in the way of making money, because the money runs out. The free money does run out.
Demetri Kofinas:	40:38	So I mean that's one place where we've seen pushback. We talked about some of the pushback we might have seen in the repo market. Another place has been in the IPO market. This was a spectacular fail. I mean, Uber was the first, I think, SoftBank investment that really went sour, had a really crappy IPO and it's trading well below its IPO price, and even its listing price was below SoftBank's latest valuations. In the case of WeWork, SoftBank actually bought out Adam Newman, so they're sitting on who knows how many unrealized losses from these investments. So, what do you think the significance of this is? How much longer do you think this can go on? Or have we already reached the tipping point in this part of the market in venture and early stage?
Jim Grant:	41:22	I think this part of the market has tipped, but you'll notice that ... in fact, I think the President United States might have remarked on this today and a tweet, the stock market keeps going up. I think he did.
Demetri Kofinas:	41:32	He's doing that for a while.
Jim Grant:	41:34	Yeah. It's not just that the most speculative wing of the venture capital industry has got to hit the wall. The problem goes a little bit deeper in that the suppliers to that particular segment of the unicorn world is also now hurting, the people who furnished WeWork with artisanal draft beer, so no more beer orders from WeWork. And there's been a great big network of suppliers set up to service companies that make no money. And so those companies are hurting. I don't think that network is quite big enough to have a macro economic impact, but it doesn't help things along.
Demetri Kofinas:	42:22	What about the leverage loan market? Maybe you could tell our listeners what leveraged loans are, because that's one place where that's much more similar to what we did have in 2008, because these are collateralized in some cases.

Jim Grant:	42:34	A leveraged loan is one of these mystifying terms. Leverage connotes debt, right? Leverage loan would seem redundant like botanic garden. Every garden's botanic, right? Right. So, a leveraged loan is a loan to a speculative grade company, meaning a company that is encumbered with debt, but to allow the credit, that's a leveraged loan. And so, it's a corporate loan and such companies will borrow, for example, when they're in the throes of being taken private by a private equity sponsor or promoter.
Jim Grant:	43:08	So let's say a company is trading in the stock market for evaluation of $1 billion. And along comes some private equity guy says, "You know what, that company selling for $1 billion is actually a bargain because they probably have too many people and they are not as efficient as they might be under our stewardship. And we're going to buy out the public stockholders for a billion 200 million and we're going to make it more profitable and we're going to take out a huge chunk of change for ourselves, and we will borrow some of that."
Jim Grant:	43:44	So they take out loans, they buy out the public stockholders, and they pay themselves a dividend, and those loans are called leverage loans. And not necessarily bad, it all depends on what the scale of lending is and how able is the company to service the debt. But as the years roll on, as the credit cycle as we call it gets a little rank, as people take more risks, as people become a little bit less mindful of what happened the last time, as they become bolder, the terms and conditions of lending get easier. That is to say people in need of income, and everybody seemingly has need of income because the interest rate is so low, those people aren't so demanding of the terms on which they lend. And typically, these terms include such things as a limit on how much the company can borrow. Or the terms might include a definition of the collateral the company must keep to support and sustain the asset value of backing the loan.
Jim Grant:	44:50	But as the years have worn on since the last crisis, these terms and conditions have become eviscerated, and some of them have vanished altogether. So, it's been a borrower's market and the market has grown substantially. But we're starting to see now that a lot of these loans, not a lot, I should have the figures in hand, but increasingly the news is that the weaker credits are failing, and that some of these loans are not being paid on time or are on the verge of default, and loan prices therefore in the open market are trading lower. So, the leverage loan market is seemingly becoming an object of suspicion rather than of fun.
Demetri Kofinas:	45:33	And there are also ETS that are built on this type of stuff.
Jim Grant:	45:36	Yep.
Demetri Kofinas:	45:37	So is this cause for concern in terms of contagion, or again, is this really not something that, because hindsight's always 20/20 or maybe that's the wrong term, I'm actually thinking of recency bias, the focus is looking at what happened in 2008 and using that as a template.
Jim Grant:	45:54	But most people, I think, are not so mindful of what happened in 2008. Many people on Wall Street were not around in 2008, and it's becoming rather ancient history.

Demetri Kofinas:	46:03	And like you said, people need the yield. It's attractive in this world.
Jim Grant:	46:07	And people perhaps are getting a little tired of hearing about the risks, because the risks, while now becoming manifest rather than hypothetical, these risks still have not wrecked careers.
Demetri Kofinas:	46:19	So, Jim, I want to move us to the overtime, and it'll be an opportunity for you to give our listeners some, maybe advice is too strong a word, but I'd love for you to talk about some of the companies that you've covered because in terms of individual stocks, you've really done a great job. WeWork was one example, AT&T is another. But I also want to ask you what you think the impact that the election may have and if markets have really been pricing that in.
Demetri Kofinas:	46:44	So, for regular listeners, you know the drill. If you're new to the program or if you haven't subscribed yet to our Audiophile, Autodidact or Super Nerd tiers, you can do that by going into the summary for this week's episode and clicking on the link that sends you to patreon.com/hiddenforces, where you can listen to this week's overtime with Jim, where we're going to keep the mics going and we're going to talk about AT&T, we're going to talk about the election, maybe talk a little bit about gold, which has had a pretty good run recently, and also where you can get a transcript of this week's episode as well as a copy of this week's rundown full of unicorns, flattering mirrors, some charts of US short term interest rates and the repo market. So, Jim, hang in there and we're going to keep it going.
Jim Grant:	47:33	All right.