MACRO Voices
with hedge fund manager Erik Townsend

Jeff Snider: The Eurodollar Curve Says Deflation Not Inflation

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Erik: Joining me now is Jeff Snider, Chief Investment Strategist for Atlas Financial and author of the Eurodollar University. Jeff prepared a terrific slide deck to accompany this week's interview listeners, you'll find the download link in your research roundup email. If you don't have a research roundup email, just go to our homepage macrovoices.com. Click the red button that says, looking for the downloads just above Jeff's picture.

Jeff, we've had so many guests on the program talking about secular inflation. Inflation not being transitory expecting it to be persistent. And of course, that leads to all kinds of follow on predictions from there. I've been looking for contrary views, and I knew I could count on you for one with respect to the inflation call. So let's dive into your slide deck and go through the big picture of why you see this macro economy a little bit differently than the inflationists that we've spoken with.

Jeff: Well Erik, it's no wonder why so many people have thought that inflation is going to be a continuing problem because obviously it has already been a problem. Consumer prices have accelerated wildly as everybody knows, particularly in the energy markets over the last year. But for me, it was always a question of and we had this discussion last time it was on last year, I think, where was it actual monetary inflation? Is this really inflation? Or is this a transitory supply shock and I know people hate that word transitory because in the modern perception at least, attention spans being what they are, you don't associate with maybe a multi-month or even multi-year period with the word transitory. But yet, in macro timescales, time and again, we've seen throughout history that transitory can last a lot longer than maybe you think it is. So we start with the fundamental possibility of whether or not consumer prices were rising as being caused by excessive money printing, currency, whatever you want to call it, or through other reasons. And for me, the monetary system did not change at all in 2020 and 2021, despite the fact the Federal Reserve went nuts with quantitative easing. But the monetary system has been telling us all throughout the last couple of years that it was not inflation, that it was a transitory supply shock. And now the markets are all uniformly describing now in July of 2022 the downside of the supply shock rather than continuing secular inflation.

And we can start with on the slide deck, slide number three, we have a diverging views being priced into several markets versus the mainstream markets, including or that mainstream narrative, including what the Federal Reserve is projecting. You go back to what Jay Powell was talking about in the middle of June, the last time they did their rate hike press conference, biggest rate hikes since 1994, 75 basis points, the Federal Reserve is clearly committed to it's now what is now it's it's basically a single mandate, which is it's going to be chasing CPIs with rate hikes. So the Fed said, hey, we screwed up last year, it wasn't transitory inflation is a bigger problem the Fed believes is I think most of your guests have believed that this is this is more than just what it was at the start. And on slide four, obviously, they're expecting that because this is a lingering problem, that rates are going to go much higher than they are now they're going to stay higher, maybe a little bit longer than anticipated. And that's not going to have any real impact on the economy, at least not according to the SCP models that are projecting unemployment to go up a little bit from its very low position where it is now, GDP, according to these models, isn't supposed to be all that bad, either this year or next year, not real, no real changes there. So according to Jay Powell, the labor markets good, the economy is good. In fact, the labor market is a contributing source to what they believe is inflation pressures, and that rate hikes need to happen and they need to happen aggressively in order to get this stuff in check. But then we go to something like the Eurodollar futures market. And it looks very, very different. It's not just you know, slightly different or a variation from the Federal Reserve's models or their projections. It is an entirely different case. And it's been building this way since last year, and has become extreme over the last couple days. In fact, the last curve on my chart here on slide five is for last Friday, July 1, and it's already changed a bunch and just today, markets are really moving in the same directions as Eurodollar futures.

And I got to stay here in case Harley Bassman if you're listening, I'm not saying that Eurodollar futures are making predictions. Because I know Harley that's a bugaboo of his and he's absolutely right to point this out. But Eurodollar futures are a set of probabilities. And we look at the curve shape and Eurodollar futures currently. How they're deeply inverted all the way into the whites. What that says is the market is preparing for a very high probability that rate hikes don't go to the end of this year. So you have the Fed, secular inflation rate hikes are coming for a very long period of time, they're going to be ultra aggressive. And then the market more and more and more certain nothing is ever completely certain. But the probabilities have gotten very high, which is why you see these really nasty distorted curves and Eurodollar futures and others, which are saying, hold up here, something else is going on, and that something else is going to likely interrupt the Federal Reserve's rate hikes schedule and plans if not interrupt them entirely to the point where they actually have to turn around and start aggressively cutting rate hikes, because that's the dip in the inversion of the Eurodollar futures all the way through the Reds into the Greens now. So the markets are going in a different direction than Jay Powell and the mainstream inflation case has been. And slide six, there's been any number of somewhat excuses or attempting to justify how we could just wave our hands and say, let's just ignore the signal coming from Eurodollar futures. One, people say, well, Eurodollar futures are nothing more than hedging, to which the reply should immediately be well, yeah, of course, that's what they are. They're hedging instruments. But they're not just hedging instruments that you or I Erik are using. These are these are instruments that are being used to hedge trillions upon trillions of dollars of fixed income portfolios and risk positions all throughout the global economy. So if these massive players throughout the global economy feel the need to hedge in such a way that it upsets the Eurodollar curve meaning that they're preparing for lower interest rates in the immediate future, rather than where interest rates are supposed to be, according to the mainstream narrative, you need to pay attention to that. And that's something that has happened repeatedly throughout history including just a couple of years ago in 2018 and 2019 when the Eurodollar Futures Curve had inverted in June of 2018, beginning in June of 2018, signaling the same thing. These massive players, deep in the money system, deep in the fixed income system were hedging against the possibility that the inflation, Jay Powell aggressive recovery, all that stuff was wrong in 2018, and 2019. And eventually, it would lead to lower not higher rates, which was proven correct.

Eurodollar futures had done the same in 2006. And 2007, predicting the higher probability of what became the Great Recession and global financial crisis, they had done the same thing, starting in 1999 and 2000s, before the dotcom bubble. You had inversion in the Eurodollar Futures Curve. So even though this is quote, unquote just hedging, the people who are doing the hedging and what they what they're hedging representing is something you need to pay attention to, and the fact that it's the history of Eurodollar inversion has been repeatedly validated is another factor to consider. But many people in the mainstream have said, this time, this time, it's different. So yes, maybe Eurodollar futures got 2000, right. The dotcom recession, maybe they got 2007-2008, right, and 2018-2019 right. But this time, it's different, the Fed isn't just going to stop raising rates, it's not going to stop its rate hike regime, it's not going to stop, Jay Powell is not going to end his press conferences, saying we need to fight inflation, because this time the CPI are different. And the Fed reaction function is different, which is meant to mean that, last time in 2018 and 2019, maybe the Fed panicked a little bit because of what happened in late 2018, the stock market started to fall, some negative indications in the economy, and they didn't need to necessarily accommodate the markets, which wasn't actually the case to begin with. But either way, this time is different. the Powell, the Fed, every FOMC speaker has said, we are going to set aside our unemployment mandate or max employment mandate and focus exclusively on the CPI. So this time, the Eurodollar Futures Curve must be wrong because the Fed is not going to stop raising rates because inflation is such a big problem.

And there's something historically go to Slide seven, that certainly Fed officials have talked about the Eurodollar Futures Curve and have said, we can't take this thing literally again, Harley's point we don't take it literally. It's about probabilities, and that these inversion periods as Dudley was saying in 2007, this hedging could push implied yields on Eurodollar futures contracts lower than what would be consistent with an unbiased forecast. Well, that's the point. It's not an unbiased forecast. It's the Fed's forecast. So what we're really saying here is the Eurodollar futures market is betting against the Fed. Even though the Fed in 2022 has said CPI CPI, CPI, we're going to aggressively hike rates. And so what you see on slide eight, is that the Euro Dollar futures market on the left hand side, the front end of the curve, the frontend contracts have indeed priced in this one trick pony Fed reaction function, which is the Fed is going to be aggressive. As that reaction function has been priced into the front end of the Eurodollar Futures Curve. The back end has remained resolute and constant throughout the entire period, which means that the market knows the Fed is going to be aggressive or the Fed wants to be aggressive. And the back end of the Eurodollar Futures Curve is saying, too bad.

We don't agree that the Fed is going to continue raising rates anyway. Yes, they want to, they think they need to, but something else is going on in the economy that these hundreds of trillions of dollars in risk positions require being hedged in this manner, which suggests that the Fed, despite its intentions is not going to make it to the end of the year with its rate hikes, even though CPIs right now are at 40-year highs. Even though Jay Powell is as aggressive as any Fed chairman has been since 1994. All of that stuff doesn't matter. The Eurodollar Futures Curve is increasingly certain, it's never 100% certain, but is increasingly positive that none of that stuff matters. There's other things going on in the economy. And then we have to figure out and ask ourselves, what would it be? What could possibly happen over the next couple of months that would force Jay Powell to get out of his one mind, or his one trick mind, focus on CPIs and maybe start cutting interest rates. And that's nothing good to be sure. And that's also nothing that's going to be inflationary. And it's not just Eurodollar Futures Curve, though this is just this is just where the where the divergence and opinions is most of the contrast is so sharp, where the Fed in most mainstream narratives are inflation, inflation, inflation. And here we have a market that's based on three month LIBOR, which is supposed to be related closely to the federal funds targeting and what the Federal Reserve does. And yet, the market is increasingly certain that something is going to go wrong in the Feds very own backyard.

So if you go to Slide 9 and slide 10, what you're seeing is that this isn't just about rate hikes, though, this isn't just about this year CPI. As you can see, going back to last year, the Eurodollar Futures Curve began its journey toward inversion all the way back in October of last year. It first inverted back in December, long before all this reaction function nonsense long before all of this aggressive talk from the Fed, there was growing angst and uncertainty growing need to hedge in this massive market going back to October, which not coincidentally, if you go to slide 10, you'll see the same thing in the US Treasury yield curve. Now, of course, we've heard all sorts of excuses and talk about how we shouldn't pay attention to the yield curve, either the Fed buys bonds we don't need, we can't really depend upon it signals. But like the Eurodollar Futures Curve, it's not one thing or another. It's all the things. So since the middle or early part of October, we've seen flattening and then inversion and Eurodollar futures. We've seen flattening and now inversion, especially today, and the Treasury curve, all of these markets coincidentally, and corroborating fashion saying the probability that the probability that we're going to have sustained inflation from 2022 and beyond was diminishing over time. Because remember, a flattening yield curve is about growth and inflation expectations built off the short end of what the Federal Reserve is doing. So the more the Fed, raised its raise its rates and forward guidance didn't matter to the market, because the market continued to project lower and lower inflation and growth potential off of that.

Why is that? So what are we really talking about here? Slide 11. What is it that's bothering the Eurodollar futures market? The US Treasury market? Why is the dollar skyrocketing? Why are all of these things happening? Well, the first easy thing, I think that one factor that most of the public seems to be coming to terms with and has already come to terms with is that there's very likely to be a recession, not just in the United States, but around the rest of the world. Go to slide 12. I mean, Facebook and Mark Zuckerberg was said, we were preparing for one of the worst downturns we've seen in recent history, and that they're going to lay off workers, as Tesla has already. You know, Elon Musk has already said, despite Jay Powell's assurances that the labor market is strong. And maybe it kind of looks strong over the last couple of months. But that's not likely to persist through the second half of the year. Again, that's what markets are proposing that the global economy is about to undergo changes that are going to look more like recession than not, I mean, the GDP now's the projections for GDP in the second quarter of this year. We already had a contraction in the first quarter. So I'm not looking for any kind of technical recession. I think the technical recession, the two negative quarters of GDP are more about confirming the fact that we're heading into a real recession, recession *recession*. And that's really what's one of the reasons why markets are pricing the way they are.

Slide 13, very bad news for Mr. Powell because FRBNY, The New York branch's own DSGE model has said, we kind of get in this recession feeling too. He might go on TV and say the labor market strong and the economy's otherwise healthy to withstand all the stuff that he plans on doing. But the updated projections between March 2022 and June 2022 don't conform to that analysis. In fact, the downgrade was so bad that it now put the June 22 projection midpoint where the lower bound had been in March 2022. So FRBNY's models are picking up serious degradation in economic circumstances and potential going forward. Now, literally taking these models literally what you don't do, what they're projecting is that real output in GDP over the next two years so 2022 and 2023 are going to be lower in the fourth quarter of 23 than they were in the fourth quarter of 2021. And that doesn't tell us how we get to that point. But what the models are saying is that there's a high enough likelihood that between the end of 2021 and the end of 2023, something is going to happen that will cause GDP or output to shrink, and then maybe not come back all the way that could be a nasty recession in 2022. It could be a shallow, prolonged recession throughout 2022-23. It doesn't matter at this point, because what does matter is that the models themselves are actually picking up the material degradation in the US economy and extending that globally.

One of the reasons we go to slide 14, the labor market contrary to what Jay Powell says, is really not in all that great shape to begin with. First of all, the long term. We have fewer jobs in May of 2022, which is the last payroll report we had, we'll get the we'll get the June payroll report at the end of this week. But as of the data we have, there are fewer jobs in the economy in May of 2022, than there had been in February of 2020. So two years, supposedly red hot recovery, and there are fewer jobs. And that, of course doesn't take into account the five if not more than that 5.5, maybe 6 million of jobs that didn't happen because it never had a chance to happen. So in terms of the labor market, I know people have been convinced of this great resignation, labor shortage. But the fact of the matter is, we have fewer jobs, we have a bigger problem, a much larger participation problem this time than last time. And we've seen this happen before. The same thing happened after the 2008 crisis, where the job market never really did come back even though the unemployment rate continued to fall. And economists and policy makers made all sorts of excuses about why that was just as we're hearing over the last couple of years how well the economy must be red hot because of consumer prices, yet, we still have fewer jobs. So entering 2022, the labor market has never recovered, which of course, creates the very fragile macroeconomic situation rather than a robust one as Powell is trying to predict. So that's one thing that the Eurodollar futures market and Treasury curve are taking in account of. As is the latest labor market data, not only do we see in the ISM numbers where their employment metrics are falling below 50. In the household survey, that actually shrank for the first time since 2020 in the April data, and then didn't recover all the way in the May data. So we have the first two months decline. And the household survey, which indicates because it's two months, the household surveys is very noisy month to month, because it lasted for two months, that indicates a very high likelihood that maybe there's something going on in the labor market already, which then gets back to what the curves are all pricing. And we can you just continue going through macroeconomic data.

You go to slide 15, I think a lot of people are aware of consumer confidence the University of Michigan survey at a record low lower than 2020 lower than 2008 to 2009. The IBD tip economic survey, their index, lowest since 2011. 2011 was not a good time to be compared with so consumers already in the dumps. We get questions about the labor market. We got cryptocurrencies crashing, which is you know, if this was a secular inflation period, why isn't the what's supposed to be the primary way to protect yourself against inflation, why are cryptocurrencies crashing when it should be shining. This should be the digital currencies moment to shine, yet something else is going on and look at where it changed. It goes back to October of last year, same as Eurodollar futures, same as the US Treasury yield curve flattening, we're getting a consistent signal that goes all the way back into last year that tells us something's going wrong.

If you go to slides 16, this is not just a US problem, it's a global problem. You see it in the rising US dollar too, which is, today it's spiking again, which is nothing good. The US Dollar is a global bellwether about global financial and monetary conditions, which, again, going back to my first point, if the monetary system is there's no excess currency, there's no money printing going on. In fact, the monetary system is contracting, you're not going to end up with sustained inflation not going up with inflation for very long at all. Eventually, it's going to come with all the nasty consequences with the downside of a supply shock, as well as contraction of money, which again, ties back into what these curves are all saying, which is, something's really starting to go wrong. And it's really starting to go wrong since around March of this year. And it's not just in the United States. It's not just the US labor market. There's all sorts of contraction, indications, recession risk rising across Europe.

Erik: Hang on a second Jeff, let me interrupt you here because I want to just push back on the whole thesis of what you're saying, which is Eurodollar inversion is telling us something changed. Now, if I go back to the other thesis that our inflationists have shared with us. Most of them are talking about stagflation and the expectation has been that after the COVID crisis, the stage was set for a new period of secular inflation, but the economy is going to be clobbered as a result of the Fed pulling back stimulus. So we're going to have a recession and the recession is going to be what gets us into stagflation. It seems to me that the recession that they're anticipating is what you're seeing in your slides here. The reason is Hartley Bassman said that the Eurodollar curve doesn't make predictions. It just shows what's being discounted in. It sounds like what's being discounted in is a recession is coming. And that certainly is consistent with my view. My thought has been, though that this recession although obviously there has to be some contraction of economic activity. That's exactly what a recession is, that there would still be an overlying or underlying trend towards secular inflation, and that would get us into stagflation. I don't see what you're saying here as really countering that. You're just saying the recessions coming! Well, we've been saying that on macro voices for months now. What am I missing?

Jeff: Because it's not just a recession. It's a deflationary recession. That's really what the Eurodollar Futures Curve is saying. Because again ask yourself, what is it that's going to get Jay Powell this year out of his rate hikes, it's not any garden variety recession, because he said, I don't care about unemployment anymore. In fact, I'm preparing for the unemployment rate to go up a little bit. And the market is saying yeah, we know that. So what is it that's going to take Jay Powell out of rate hikes? And the answer is a CPI that's no longer a problem. So if consumer prices are going to come down this year, that would allow Jay Powell to back off his single mandate and go back into his more comfortable dual mandate where he's going to pay attention to what was likely to be certainly according to these curves, not just a dotcom mild recession that just backs off the economy a little bit for a temporary, short period of time. There's something a little bit bigger going on here. And that's really what these markets are saying. It's not just it's not just the not just the Eurodollar futures market is not just a Treasury or again, the spike in the US dollar exchange value is global bellwether for financial conditions, especially in the US dollar denomination global Eurodollar system. It's not just a recession. There's more to it.

And we'll get to some of the biggest dangers at the rest of the presentation here. The real deflationary dangers of money happened to be collateral. So yes, we do have what appears to be global recession. I think a lot of people have come to terms with that. There's some places where they're still in denial. Certainly central bankers are in denial. Politicians are in denial. I don't think the public is in denial, because I think most people in the public can see that what's coming, too. But the markets are pretty resolute in saying that this is not stagflation. It's another deflationary recession, that's going to back off consumer prices. And, again that begs the question, what kind of a recession we'll do that? What kind of a recession breaks the back of consumer prices that have been the highest they've been in 40 years? What kind of recession takes Jay Powell out of his I'm only going to care about CPIs and make them not care about CPIs anymore. That's really the message here.

Erik: Jeff as we're speaking on Tuesday afternoon. We've got commodities really crashing crude oil down $10 since the overnight session. We've got copper down, we've got gold down, everything is down. Is that part of what we're depicting here essentially on pages 14, 15, 16. This just trend of deflation coming into the equation for the first time in several months or is this about something different?

Jeff: Yeah Erik, I think that's really what we're talking about here is that the markets are starting to get the sense. Number one, that commodities in particular has been very favorable. They have a very favorable supply side picture for a very long time. And I don't think that's really changed. Some commodities that has, some supplies have come back up again. So we've started to rebound. This is really about demand as well as monetary risk. It's about deflation risk, especially, we see copper crashing as much as it has. Gold in particular, which is another deflationary signal, especially when it goes down. And some of the sell offs that we've seen. As well as you know, oil prices, though, oil is still relatively very high, but to fall as much as it has today. It's really all again, crypto prices, things like that. These are all deflationary signals that the market is starting, these very markets are starting to prepare for, which is not just your usual recession. There's a little bit more to it there. There's a little bit more emphasis there. And when you look at it, I probably didn't do a good enough job describing the Eurodollar curve or the yield curve, and just how much it has changed over the last several weeks in the last several days. It's not just your usual hey, we're kind of worried about a recession. It's hey! We're worried this is going to be a quote unquote, recession, which is more likely deflationary than not. And I think that's why the curves have changed as much as they have.

And as I was saying, in slide 16 and of course slide 17 too. We talk about it's not just a US phenomenon, because this is a Eurodollar, global monetary issue. It's a global economy phenomenon. And you're starting to already see if you go to slide 18, some of the deflationary trends develop in macro economic sense as well. One of those has been container prices. Container prices had been one of the primary ways or primary signals of the quote unquote, inflationary possibilities of 2021 and forward. You know, container prices on the China East Asia to US West Coast route, for example, got up to around more than 20,000 then peaking last October again another October signal. And they have simply crashed over the last several months, as of the last reading here, according to the Baltic index from Freightos, that the container price on that road route was less than 7500 bucks or around 7500 bucks, which is less than it was last year, even though China is just now reopening. Shanghai and some of the ports along the east coast are just now coming online and all the freight companies were expecting a bounce in container prices as well as a surge in activity as China's reopening and it didn't happen. So it's not just demand and recession risk in the US it's demand and recession risk across the entire world, including China as it reopens. And it's one market after another.

You're starting to see it of course, we have an inventory problem in the United States as well as other parts around the world, partially related to those container prices and the difficulties that they represented in shipping goods around the world. And what happens when companies especially retailers and wholesalers start liquidating inventories, prices are going to fall sharply, and they're already starting to be discounted in a lot of different places. So it's not, again, to your point Erik, it's not just a recession that hits at the same time as inflation. It's a deflationary recession that hits at the worst possible time, which is why these curves are signaling are changing so quickly. And so signaling what they're signaling despite the fact that Jay Powell and the mainstream narrative is completely lasered focus on CPI and inflation going forward when all the signs and ingredients especially today, markets are becoming more and more increasingly confident, if not certain, that the opposite is going on.

And if you go to slide 19. We'll get to the real deflationary stuff. The biggest risk in my opinion, which is always the biggest risk when it comes to money. And it's the one thing you never hear anybody talk about. Certainly never nobody ever at the Fed. And then a single word, it's collateral, collateral shortage, collateral scarcity. It has been the bane of our existence since August of 2007-2008 crisis, as you and I talked about many times Erik was never really about subprime mortgages. It was about how subprime mortgage bonds had become priced and use the same as good quality collateral when that was never really the case. Just going over slide 20 and slide 21 why that's a problem what it actually means some of the ways in which collateral is used, it's used as its own form of currency. So it is every bit monetary like as cash is. In particular 2022, we have the same problem largely as in 2018-19. Where you have a lot of crap collateral from junk corporate bonds, euro bonds around the world, things like that, that have found their way into the collateral streams and collateral system. And now that the economy is facing the prospects of less than red hot recovery, and now maybe global recession, you have this collateral squeeze. That's every bit familiar for anybody who's been paying attention over the last couple of years, except that in 2022, some of these collateral shortage indications have gotten to their own extremes, which represents serious deflationary danger. Slide 22, for example, we see in treasury bill yields just absolutely incredible premiums being paid in primary and secondary markets for especially the four week instrument, where, the four week treasury bill yield, that's so much less than the RRP or IOER represents a huge liquidity premium that the market is paying or the system actually the monetary system is paying just to acquire the best quality collateral, and at times, it infects the eighth week, as well as the three month bills too, especially early in the morning when illiquid trading, Asian trading, where the previous day's repo and interest rate derivatives and other derivatives are being unwound. Collateral calls being made, what you see is there's a massive, massive squeeze for the best quality collateral, which tells us that this system is incredibly fragile, is incredibly short of collateral. And that leads to all sorts of other risks.

And we see that not just in the T-bill market. If you go to slide 23, repo fails another indication of collateral shortfall. Just recently, in the first week of April, repo fails, got as high as they had been in the worst week of the march 2020 panic. I'll say that again. Repo fails in April of 2022 where the worst that they had been since the worst week of March 2020. And then that happened again, just recently, the last data we have from Federal Reserve Bank of New York primary dealer statistics for the week of June 22, almost half a trillion in repo fails during that week, which would have put it as again the second worst week in March of 2020. So there are extreme indications of extreme collateral shortages, which is itself a monetary deflation signal. And you can see it again, going forward to slide 24, collateral fails against something like JPY, the Japanese yen, because Japanese banks are a key redistribution point in the Eurodollar system. They're highly exposed to collateral because most of what they're doing is collateralized by US Treasuries and their ability to secure US Treasuries. And so there's a very direct and easy to see relationship between something like repo fails, therefore collateral shortage and the absolutely ridiculous tumble in the Japanese yen and look at where it's really starts again in October! Just like the Eurodollar Futures Curve began to flatten then invert, just like the US Treasury curve began to flatten and now inverts, the Japanese yen and repo fails. Those start to become, they start to elevate and Japanese yen starts to fall last October consistent deflationary probabilities and signals throughout. And as I mentioned before, another big one that checks off both collateral as well as the rising dollar, therefore, the global bellwether of financial conditions.

Slide 25, we have the Federal Reserve custody of US Treasuries owned by basically foreign central banks. Those tend to disappear when we have collateral problems in the global system. And sure enough, going back to last year, US Treasuries disappear from custody at FRBNY because foreign central banks are using them for some reason. And again, we don't have to really guess what that reason is, it's likely to be because they're facing or banks in their jurisdiction are facing collateral problems as well as Eurodollar problems and therefore there have to sell these US Treasuries at the same time of course, the US dollar spikes in exchange. Now what is it today? I think it's almost 107 on the DXY which is a very deflationary signal. The dollar, especially when it goes up, and it has a very high accelerated pace is a very dependable sign of deflationary money working its way through the global monetary system. So just finishing back up with slide 26, going back to Eurodollar Futures Curve, again, we have to ask ourselves, what would it be, what would it take to get Jay Powell out of his I'm going to fight inflation till the day I die, and do it this year? Because that's the probability that's being priced into the Eurodollar Futures Curve. And today, it's even it's being priced even more certain with more certainty more, what's higher probability and confidence. And again, it's not just by regular retail hedgers, but by those that are running trillions upon trillions of fixed income risk portfolios around the world. The monetary system itself is telling us what the risks are and the risks are not inflation. The risks are in fact rising. Probability rising potential for not just recession, but also deflationary recession.

Erik: Okay, Jeff, so you're calling for deflationary recession, a lot of other people are calling for recession. But they're expecting that recession just to pause the inflation and that the inflation would return and develop into stagflation. It seems to me, Jeff that the question really is, well, wait a minute, if the market is just pricing in, Powell thinks he's going to continue with these hikes, we all know that the market is going to take a nosedive. And that probably the Fed is going to be forced out of that policy position, because they've got to do something in order to try to rescue falling markets. And the question then is whether they'll be able to do anything to rescue falling markets, or if that would just set up a stagflationary fail. So I see what you're saying with all of the slides, and I see where they're going. But Jeff, wouldn't these slides also explain the scenario where the market is just discounting that there has to be a recession and that the Fed is going to be forced out of its tightening cycle because of the recession?

Jeff: Yeah, well, I mean, that's part of the equation here. But it's also the long run potential or the little long run problems that are that we're still facing here, which is that inflation is a monetary phenomenon. And there has been no money printing. Yes, the Fed has created bank reserves and the Fed doesn't actually tighten or loosen monetary policy, the banking system does. And so the banking system by virtue of these curves is telling us that we don't see any inflation down the road. We don't see any inflation of course during the recession, the recession gets to be bad enough to deflationary monetary conditions get to be bad enough to change Powell's policy. But this isn't just about the Fed. This isn't just about rate hikes, nor is it about balance sheet runoff or quantitative tightening. The collateral system, for example, which is well outside the Federal Reserve's ability to handle, markets are saying that the recession that we're likely in right now, if not, if we're not in it right now, that we will shortly we'll be in, is not going to be just a pause in the what everybody seems to think is a secular inflationary trend. It's going to represent the reversion to the same mean that we were in throughout the decade of the 2010s. In other words, what changed in 2021 wasn't money, it wasn't policy, it wasn't currency, it wasn't inflation. And therefore the recession represents the way in which we go back to the same deflationary disinflationary position that we had been in before 2020 COVID pandemic. And it's, again, it's not just one market or another, it's all the markets together that are talking, that are pricing and hedging against not just this year but future years. It's about long run potential, the yield curve for example. The long into the yield curve is is all about growth and inflation potential, not just today, but over the long run period, or at least as much as we can identify in the forecast. The flattening and inverted yield curve isn't just about recession in 2022. It's also about what comes after it. So it's not just about the Fed. In fact it is not really about the Fed at all. It's about the fact that what changed in 2021 was a short run imposition of consumer prices, and that those are likely done with and now we're stuck with an economy that is worse off. A financial system that is worse off, a monetary system that is even more fragile than it was when we started this whole thing, and that represents a very different long run scenario than secular inflation.

Erik: Jeff, last time I had you on the show, we talked about increasing prices that were not inflation. In other words, that there were causes for prices to increase that were not monetary inflation. Now, as you make your arguments in this slide deck, it seems to me like okay, you've made a very compelling argument for why inflation perhaps is ending, we're not going to see more inflation, where the inflation is going to come out of the system. I would make the argument though, that from everything I can see in crude oil supply and demand fundamentals. In the case of crude oil at least, I think the price is set to rise further. And it's not because I don't believe in the recession. I think the recession is coming. I think that that has to pull a lot of the wind out of the sails of crude oil, so to speak. So this huge sell off that we've seen if more than $25 from the peak to in $10 in the last 10 hours, almost as we're speaking on Tuesday. Sure, that is probably the market discounting the oncoming recession. But if I look at what a Citi banks estimate of how low oil prices could go in a recession, they're saying maybe $65. On the other hand, if I look at JP Morgan's estimate of how high the oil prices could go if Putin decides to intentionally game the west by withholding access to Russian oil and gas at the worst possible times, then they think it could go to $380. I'm guessing the real answer is in between somewhere, but I'm leaning toward oil prices continuing to move higher, regardless of inflation or deflation, just because I think there are some ingredients in that market that could be gamed by Vladimir Putin to Russia's advantage in this war. And I think it's going to take oil prices much higher not because of inflation. But wait a minute, oil prices are really one of the biggest inputs to the cost of everything. So does that have the potential to set up a feedback loop that eventually does bring us to inflation or stagflation? Or do you think that I'm wrong to expect oil prices to still be strong independent of this big wave that we're seeing in downward pressure on all commodity prices?

Jeff: Well Erik, I would…you know better than I do about the oil market. And there's no one better to ask about what's going on in terms of oil fundamentals. And if you think that the supply factors are going to be a long run problem, and I have no reason to doubt that, I think you're probably correct about that. But that doesn't necessarily mean it's inflationary. It could actually be deflationary. Because that's exactly what we're seeing right now. If oil prices go to hell, even $150 a barrel from here. Let's assume that they fall further, they settle at some eventual low because of the recession, lack of demand over the short run and then they start rising back up, because the supply, the supply factors have never been fixed. And they aren't going to be fixed in any kind of reasonable, foreseeable future. So we get into recovery scenario, oil prices go right back up to $100 a barrel, 150, whatever. That's not necessarily inflationary, either, because it could and in fact, the market is pricing that it's likely to become a drag or imposition upon growth in other sectors. If you have to pay a lot for oil prices, absent money printing, absent credit growth, and what's going to happen is that's going to rob from other sectors of the economy. Redistribution in the most inefficient, deflationary way. So if oil prices go up for structural factors, I would say that's even more deflationary because it's going to harm the global economy down the road. It will increase costs that can't be passed along to consumers, especially consumers and businesses that are already struggling. It's just going to create even bigger problems for them, which means they're going to hire fewer workers, which is means they're going to pay less for their workers because they can't afford to. You don't ever get into that feedback loop because it's not inflationary. So the higher oil prices go for structural reasons, the more likely in my mind again, going back to these curves going back to the US dollar exchange value. All of these these highly pessimistic long run scenarios. It may be that the market is thinking exactly like you are Erik and saying, what happens if oil goes up to $150 in the recovery period. What happens if oil gets to $200. It doesn't become inflationary, it becomes even less, even worse growth prospects than we faced in 2010s. And that's just a frightening long run scenario to me. That's even worse than inflation.

Erik: I want to talk about another aspect of this hypothesis that you're setting forward. Because it seems to me this could be the first time in many decades, that we had what I'll call a coordinated global recession in the sense that normally economies around the world are on slightly different time cycles. But we just had everybody in unison go through the COVID pandemic. So you get to a major natural event which should have been a real negative on the economy, but central banks around the world stimulated like there was no tomorrow. And that allowed the immediate timeframe around the actual pandemic, not to be recessionary. Now, it seems like because of the advent of inflation, central bankers around the world have to take their foot off the gas, and it's setting up a perfectly time synchronized global recession. Is that a concern? And if so, have we ever seen anything like that in our lifetimes? Because we haven't had something like a pandemic to coordinate all the time clocks around the world for every economy to set this up before?

Jeff: Sure. I would disagree a little bit Erik because I think we've seen coordinated globally synchronized economies for the last 15 years. I mean, that's what 2008-2009 was. The Eurodollar system set globally coordinated and recession in 2009 in particular across the entire world, including emerging markets, and then it happened again in 2011-2012. And they happened again in 2015 16. And then again, they even called it globally synchronized growth in 2017. They just forgot to rename it as globally synchronized recession by 2019. But again, it's synchronized. But to your larger point, I think that's the problem is that there is no way because all of these clocks have become synchronized and the COVID pandemic, and I agree with you there, the COVID pandemic only synchronize things even further. That just means that there's when we do go into a downturn, or we do get into these deflationary pressures. There's no outlet valve. There's no China for example, the US goes into recession, but China's really booming to cushion the blow. If the US goes into recession, and China goes into a hard landing at the same time. That's bad news for everybody. And again, I go back to what markets are pricing currently these curves, that's kind of what they're saying is that in this globally synchronized world. In this globally synchronized economy, especially as it's linked together by the monetary system, the Eurodollar system, that central banks by the global monetary system, that increases the potential for real havoc, disorder, financial disorder. I mean, we're seeing it today as we speak. We're actually seeing that the downside consequences of all of these things playing out at the same time, and in the same way, because there is no individual economies. There is only the global system. I think that's a mistake that mainstream economics is really badly needs to to correct. Because in the public's mind in particular, that individual economies are treated as individual economies when they really aren't. And there are all sorts of feedback mechanisms that make these things procyclical.

So once we do happen, once we do get into the downturns. That's why for example, the 2001 recession or the 1991 recession, those were relatively mild, because it was only the US or basically the US experiencing mild, moderate recessions that were not stitched together by the Eurodollar system malfunctioning. So as we go into downturns and recession potential in 2022, there is no source of strength to really stop it. Central bankers aren't going to stop it, governments aren't going to stop it for various reasons, including, as you said Erik, the fact that they're all convinced this is inflation. So the last thing they want to do is start to do, quote unquote stimulus which doesn't really stimulate. But the last thing they're going to do is try to stimulate an economy when they've said we can't stimulate the economy. So again, the downside potential builds not just in markets but in actual fact across the real economy.

Erik: Well Jeff, I can't thank you enough for another terrific interview. But before I let you go, there's been some changes in your life. You're with a new shop, Atlas Financial Advisors. Who is Atlas Financial? What's the nature of that relationship and particularly tell us more about what's going on with Eurodollar University, the ongoing podcast that you and our friend Emil Kalinowski have developed.

Jeff: The podcast with me and Emil, that's not going to change. If anything, we're going to add more to it because I now have a little bit more free time to focus on some of the things we wanted to accomplish with the Eurodollar University. Some more academic focused work to try to get people to be aware of the monetary system and things like that. But listen, I changed from Alhambra to Atlas Financial simply because it wasn't a good fit for me at Alhambra anymore. Some of the stuff that I talk about some of the risks I see in the marketplace was kind of falling on deaf ears. And it made sense to go to a firm where I could have much better input to where it would be received. At least, I don't expect people to believe everything I'm saying or disagree. But I do expect that there's at least we can agree on some of the more fundamental aspects of what we're trying to do here, which is to describe the risks that clients are facing, to describe the risks that the economy and markets are facing. And to be able to do that Atlas Financial, it was an attractive opportunity. And people may not realize that Atlas Financial is the place where Steve Van Meter, the bond king, that's where he hangs his hat. So Steve and I are going to work more closely together on developing strategies and maintaining, monitoring, monitoring the strategies he has allowing me to have more input in over the portfolio process and things like that.

Erik: Patrick Ceresna and I will be back as MacroVoices continues right after this.