MACRO Voices
with hedge fund manager Erik Townsend

Jim Bianco: CPI, FOMC, China & More

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Erik: Joining me now is Bianco Research founder Jim Bianco. Jim, it's great to get you back on the program. We have quite a bit of news this week, CPI and FOMC. Let's start with CPI. Give us the update, what was the data and what does it mean?

Jim: Data came in weaker than expected and expected is the key word. And on a year over year basis, it was 7.1% is what the growth rate is November to November. And core CPI came in at a 6% growth rate November to November slightly below what was expected. The market I want to say predictably took off on this news. But that understates the reaction that the stock market had. We talked about this a little bit later, but we were up 3% next trade on the S&P off of CPI. We also did that a month ago off the CPI. I think those are the only two examples I could find of the market being up 3% next trade in the last couple of decades. I can find examples of being down, but not necessarily being up like that, just to show you how focused the market is. But turning back to CPI, you could attribute most of the undershoot in expectations to two categories. Used car prices fell and gasoline prices fell. So all in all, it was a report that has everybody thinking inflation has peaked. Now, I've also argued that inflation is peaked. It actually peaked in June and for people to say that see this, is it inflation is peaked correct. But that's not as important as the next question. Is it on its way back to 2% or is it on its way back to four because either one of those is going to produce a vastly different response out of the FOMC and out of the market. 4%, the Fed is only at neutral. The hike that they did, we're recording the day, the FOMC which we'll talk about in a second. The hike only got them back to neutral if we're going back to 4%. CPI. If we go back to 2% CPI, then they are above in tightening category. And they might have some room later this year to ease. I happen to be in the camp that inflation is probably going to stop closer to 4% than it is to two. So yes, it's peaked. Yes, that's been obvious even before the CPI report this week. But again, it's really all about how far down is it going to go? Not? Is it going down?

Erik: It seems to me that I think of waves on the ocean. Yeah, there's little waves on top of big waves. And it seems to me there's two components here, Jim, there is a transitory inflation effect that has everything to do with the pandemic. And everybody seems to agree that that's an effect that is pandemic driven. There may or may not also be a larger wave underneath that surface wave, which would be a new secular inflation trend. It seems like not too many people agree with me that there probably is an underlying bigger wave. It sounds like from what you're saying. That's what I'd like to clarify is when you say we're headed back to 4%. Does that mean you think this is transitory effects of the pandemic but it's just not done yet? Or is it because you see what I see, which is maybe there's a bigger wave, the small wave, which is transitory effects is peaked. But that small wave is still sitting on top of a bigger wave, which maybe hasn't peaked yet?

Jim: No, I think you put it well. And, you know, I'm going to restate a little bit of what you said, Yes. First of all, inflation was in June at 9% and it's fallen to 7.1%. It better have peaked because if you're going to tell me, no, the inflation rates can be between seven and nine for the next year and a half, stocks might be as much as 50% too high. And we re-run 2008 if not worse, if that's where they're going to stay. Now, I don't think they're going to stay, they're going to come back down. So why are they why did it get to 9% and why is it deflating? You're right there was some stresses with reopening of the economy, supply chain constraints, excess savings, which was pushing demand, because of all the fiscal stimulus in 20 and 21 that got you to 9% that's coming out of the system. But when you settle it out, I do think that structurally in the post pandemic era, we're going to probably settle out at a higher level than we did before. The old level was two, I think the higher level is going to be closer to four. And maybe it's three and a half or so. But my main takeaway is significantly above two. Why? Secular forces that have taken place post pandemic I've referred to them as the end of cheap labor, cheap goods, and cheap energy. Cheap labor, we still got sub 4% inflation, we've still got wage growth, we've still got labor hoarding by companies. It's hard to find workers. A Statistics Jay Powell likes to cite is there's 6 million unemployed people. There's 10 million open jobs in the United States, that's a 1.7 times open jobs to unemployed. We've never seen it this high before. So you know, the worker is in the driver's seat. The worker can make demands like, I want to work from home a couple of days a week, I want a bigger raise. And if you don't give it to me, I'll quit. And I'll go find another job that gives it to me. So end of cheap labor and of cheap goods.

Look, I think we're at peak globalization. The week we're recording, the Biden administration has already come out and sanctioned another 30 Chinese companies, tech companies because of the ongoing tensions with them. We'll talk about zero-COVID and all of the problems there. But the idea that offshoring your production is going to produce cheap goods, I think is is in the rearview mirror as well. And cheap energy, that's all about Russia. Russia is the biggest energy producer. Saudi Arabia might be the biggest crude oil producer, but when you add in natural gas and everything else, I think Russia is the biggest energy producer. They've shut down Nord Stream. There's a lot of stress with Russia. They're not going to become a cheap energy producer again, anytime soon. Again, the week we're recording, the Biden administration is thinking about sending Patriot missile batteries to the Ukraine and Russia has already announced well if they're going to do that, we're going to have to take them out. Doesn't sound like we're anywhere close to, you know, having a kumbaya moment with Putin and reopening up the natural gas spigots to Europe. So the cheap energy era is over. Yes, these can be replaced. We can find a new source of cheap energy, a different source of cheap labor, or some other globalization 2.0. But that will require a lot of infrastructure spending, as in in trillions of dollars in many, many years to restructure a global economy for that type of environment. And that means along the way, higher frictions, higher inflation, higher costs

Erik: CPI was Tuesday's news. Wednesday afternoon, just a couple of hours before we're recording. Now, late on Wednesday afternoon, the FOMC met, they raised their benchmark Fed funds rate by another 50 basis points. Now, the last time they raised it this high was 2007. Nothing bad happened after that, Jim. So what does this mean?

Jim: You know, it's interesting because there seems to be two narratives out there. There's the Fed's narrative in the markets narrative. The Fed's narrative, and to be clear for most people, if you were to put the Fed in one of those Hawk dove meters, you know, who's the most dovish person and who's the most hawkish person. I would say to you that the most dovish person might be vice chairman Lael Brainard. And the most hawkish person might be chairman Jay Powell. Now, this is unusual because usually the vice chairman, the chairman is somewhere in the middle, but they kind of occupy the extremes. And there's a lot of tension at the Fed. Wall Street Journal, Nick Timorous wrote about it this week, that there's not a lot of disagreement within that room about what policy should be. And I point that out to remind everybody, the Fed's a benevolent dictator. The Fed Chairman gets what the Fed chairman wants, and the Fed chairman is hawkish, and he wants more rate hikes, he wants to stick at the terminal rate a lot longer than people think he wants to make sure that inflation is unmistakably going back to 2% before he even thinks about cutting rates. That's what the chairman wants. That's what the Fed is saying. The market seems to be saying, Jay, I hear you. Jay, I understand. But Jay, you're going to change your mind in the next three to six months. You're going to see data that says we're in a recession or close to recession. You're going to see data that says, just like the last two CPI numbers, it's falling a lot faster than you think. So Jay, you may say that now in mid-December but wait till the spring Jay. You're going to see data that's going to make you think like us, it's time to start cutting rates. It's time to start ending this rate campaign. And it's time for the markets to embrace and celebrate that we have cheap money returning.

Erik: Jim, let's talk a little bit more about the terminal rate where they eventually stop hiking rates, as you just described. It's really not I think, just Jay Powell, because if you look at the dot plot, all of the participants seem to want to know about Lael Brainard, but most of the participants in the FOMC seem to think that the terminal rate is going to be higher and farther out than the market thinks and the markets not buying the story. So who do you think is going to be right? Is the market being complacent or is the Fed being unrealistic? If you had to bet on who wins that that tug of war that you just described where the market doesn't believed the Fed? Do you think that Jay Powell is going to stick to his guns and say no, I meant what I said, we're really going to keep on raising until we get to 2% inflation, or do you think the market will be proven right and that Jay Powell is bluffing will be called so to speak and he'll have to reverse course?

Jim: Well, let's put some parameters on it because I don't think that the market and Jay are quite as far apart. Yes, the terminal rate for those that are not familiar with the term that means the highest rate where the Fed stops raising rates. The market expects that rate to be somewhere between 4.75 and 5% around June, that's where the market is. The Fed had, as its year end target for the funds rate. Because they put out a dot plot, where do you think the funds rate is going to be in 2023 of 5.1. So that means 5.00-5.25 as suppose to 4.75-5.00? So there's a difference in the markets there between 25 basis points. Of course, the dot plot is where do you think we're going to be at the end of the year, so the Fed is saying, we're going to be at, you know, 5.10 at the end of the year. But in 2024, the Fed dot plot has it at 4.1. So they will be cutting rates in 24' by 100 basis point. So where the market is, is Jay you're going to go to five-ish, maybe it's 4.75, 5.00, maybe it is 5.25 but let's call it five-ish. And then the market thinks before the end of this year, you'll be cutting rates. The Fed is saying what their dots, no those rate cuts will come next year, or next year being 2024. And so really, there's just a quibble about timing here. But the broad contours are correct. Now, who's going to be correct? I'll point out to you that largely this year, the Fed has been a giant bully. It has been raising rates by 50 by 75, by 75, by 75, by 50 again and all year, the market has been saying that it's got to stop. Fed's got to pivot Fed's got to pause. These are the words that we've been using, and the Fed hasn't. Now the big reason the Fed has not is two reasons. One, inflation has stayed up, it's still 7%. It's still unacceptably high, even though it's coming down and two, there has not been any serious signs of a recession yet, other than housing and housing is very interest sensitive.

You haven't seen any real weakness in labor. You know, we still produce well over 200,000-250,000 jobs a month, according to payroll report. We still have well under 4% on the unemployment rate. Initial claims are down as well, too. So there's very little signs that the economy has produced a recession. Now what would get the Fed to buckle would probably be if you were to see zero job growth, negative job growth, serious signs outside of housing, that you have a recession. If you did that, then you could apply the Lael Brainard could apply pressure to the Fed, and or to the chairman and say, Jay, you can't keep throwing people out of work to date that hasn't been happening. So I'm going to come down on the side for earliest, for now for early that the chairman is going to get with the chairman wants only if the data really turns south soon. And I want to be clear that South soon, do I think that the data is going to weaken for the economy? Yes. Do I think that there's a probability that we're going to have a recession? Sure. Even though it's probably the most discounted recession in history, but where I might differ from the crowd is, it might be a third or fourth quarter or first quarter of 24 story, that that serious slowdown shows up several months away. Wall Street wants to slow down by the second week of January. So they keep talking about a pivot. So they could continue to engineer a stock rally based on the idea that we're going to have cheap money. So Wall Street's impatience might not be rewarded. And that's why I think the chairman is going to get what the chairman wants, and he's going to stay hawkish for longer.

Erik: Let's talk about treasury yields a little bit farther out on the curve, because I agree with you, Jim. I think that yeah, we're headed down in inflation, but nowhere close to 2%, I think at least 4%. Well, hang on a second. Jim. If I look at the 10 year yield, it's back down below three and a half percent now. So clearly, the market doesn't think that inflation is going to last for 10 years. I think it is, what do you make of the longer term yields and how the back of the curve looks, what message is that giving us?

Jim: Well, let's start with longer term yields, you are right, they've come down from about 4.40 to about 3.50. 4.40 was set, you know, in early November, so in the last five weeks or so they're down almost a full percent point. I would also throw out just to describe what's happening in the market, short term interest rates, the funds rate, the two year rate are up, and the curve is the most inverted. In other words, the two year yield is about 75-80 basis points above the 10-

yeaar. You have to go back to 1981 to find the curve that inverted. So what's the message from the market recession? The message from the market is the Fed is going to be too slow at recognizing the signs of recession. That's why short rates are up, long rates are down because we are going to see a recession sooner rather than later. That's what the inverted curve signaling is that like I said, that could be correct. An inverted curve, but the timing might be a little bit longer than people think. An inverted curve leads a recession on average, by about 10 months. Can be as much as 18 months. It's not three or four or five months, the curve consistently inverted. And I'm talking about the 10-year-three month curve, because that's the one all the research has been done on only in the last month. So that would put you in a standard recession in the fourth quarter, not in February. And that's really what the market again, it comes back to this idea that the market is impatient and wants to see signs of a slowdown. That's where I think you're seeing with the 10-year, and with the inversion of the curve. Now technically, if you backed up your charts and looked at the charts all the way back to January, has the market broken down from its major uptrend? I don't think it has. I'm not so sure 440 was the high yield for the cycle. That was set in early November. You know, if you go back and you look at June to August, we saw an even bigger drop of about 150 basis points on yields before they turned around. And they made a new high.

So I wouldn't be surprised if this is just a standard correction within a larger uptrend in by the first half of the year, say spring summer, we're back towards that four and a half percent if not slightly higher on the funds rate. One other thing about that, too, let's assume that the Fed, let's assume that the Fed follows through raises rates to somewhere at around 5%, you know, 5.00-5.25 to 4.75 to 5.00. The two year note yield I mean, diverge this for a second to the short end, the two year note yield started trading in 1976. Every rate hike cycle, the high in the two year yield is above the eventual terminal rate, the two year yield hit 4.71. We're going to go to 4.75 to 5.00 or 5.25. This would be the first rate hike cycle that the two year yield ended below the terminal rate. So I do think that the two year yields high is still ahead of us as well, that could be off near five and a half. I don't think the yield curve is going to go minus 150 basis points. If it stays at minus 100. I'm talking about a scenario here, where we're looking at 550 on the two year note, 450 on the 10 year note, somewhere in the spring or summer. I know I've given specific target and I always know when I get specific targets. That's usually what doesn't happen. But conceptually, is what I want people to think about what I'm saying not literally so that both rates are going to go higher. And it's going to end we're not done, especially if the terminal rate is still ahead of us. And it's much higher then we've seen so far.

Erik: Jim, something I find interesting is lots and lots of people in the marketplace are talking about what you and I are talking about right now, which is higher rates of interest on government debt mortgages and so forth. And there's been a lot of analysis of, you know, what's going to happen? Can the US government tolerate higher treasury yields because they've got to refinance their debt and so forth. What I don't see discussed anywhere really is an analysis of the high yield debt, the companies that have to finance at fairly high interest rates, they in many cases similar to the federal government, have shorter duration debt, that risks having to be refinanced at much higher rates as they roll that debt over. And it seems to me like there's potentially a domino effect there where if they can't afford to roll their debt forward, those companies are at risk. You get downgrade risks of companies that are above junk getting downgraded to junk. Is there a story there? Is there an investment play there? How should I think about the high yield market?

Jim: Yeah, there's two stories there. The first one is the moral hazard story and the moral hazard story. Most people are more familiar with this story in the equity market. Get in that is basically I can't believe the Feds raising rates so much I can't believe the Fed is hostile to the stock market. I like to joke, Erik that the investment strategy from 2010 to 2021 was you bought the S&P 500 index fund, and then you wine to the Fed Jay, you got to do more work to get the stock market up, because I'm not making enough money to buy a new Tesla here. So come on, keep going Jay, cut rates, you know, do more QE because my spiders are rallying enough. That was the moral hazard. Well, the moral hazard in the bond market especially in the high yield market, was born out of 2020. In 2021, the Fed stepped in with its emergency programs. It started purchasing high yield debt and high yield ETFs. Bob Michael, who's the chief fixed income strategist at JP Morgan summed it up best, I'm buying high yield. He said in the spring, early summer of 2020. What are you crazy Bob? The spreads are wide, we're going into a terrible recession. And his answer was very simple. I'm co-investing with the Fed. If the guy with the printing press is going to make sure that those yields are not going to go what back wider. I'm not going to, I'm not going to fight him and he was right. That lingers in the high yield market today, I believe. So when people ask, why are spreads so tight in the high yield market, because at the end of the day, if things get ugly, the Fed is already set the precedent in 2020, they will print money, and they will make sure that those spreads, stop widening why? Because they did two years ago. And so that's why I think spreads are so much tighter than it is now. And it's enabling a lot of zombie companies to stay zombie companies instead of dying off because they can't get financing. They're still existing. Now, I said that it's not as easy as it was a year ago. But it's not as difficult as it could be. And if I'm correct in what I said earlier, that the downturn in the economy, while I agree with the consensus, it may happen, but it's way off there later this year in the 24, you could see high yield run into trouble at that point, especially if the market starts realizing and this is a possibility, look we got a downturn, but we also have inflation. I'm tough on the downturn here, we got to do something about inflation, and then he's not going to turn around and be your co investor in the high yield market. So to one extent, if the question is why are spreads so tight relative to everything we've seen, it is the moral hazard that we saw from 2020 right now, but we haven't seen the downturn yet. And if that really comes in the second half of the year, then I think we could see high yield run into trouble. One last thing about high yield. If all of the major capital markets, it is the most subject to boom and bust. High yield only knows one thing overdo it. It over does it on the tightening it over does it on the widening. It swings wild too wildly from one extreme to another extreme. So maybe it's at one extreme now. And that will be offset by a future extreme in the other direction.

Erik: Jim, I wanted to start with fixed income, because that's your specialty. But I'm sure a lot of our listeners want to know, okay, what does all of this talk mean for the stock market?

Jim: You know, that's going to be interesting to answer because I'm going to answer it this way. The stock market, if you look at forward P/E ratios, and that is what is the estimate on Wall

Street of 12-month earnings divided by the price? It's 18 and a half on the S&P. If you look at it for two years out, or three years out, yes, Wall Street does have estimates of those. It's 15 and 17. These are not cheap numbers. This is not a cheap market, by any stretch of the imagination now might not be the upper 20s, which we saw in late 2020 and in 2000. But it's certainly not 10 or 11 on the four P/Es like we've seen at the bottom of previous recessions. And so what people have to understand is, what is the justification for buying 18 multiples on the stock market ahead of a perceived recession? And the answer is they're discounting an interest rate, they're discounting a three and a half to 4% funds rate in 2024. The market, people talk about the market pricing in 5% on the terminal rate, I'd actually argue it isn't. What its pricing is yeah, J is gonna go to the terminal rate because he has to because he said so. But then he's going to turn around and he's going to start cutting rates at the first sign of weakness. And eventually we'll get back to 4.00 to 3.00-3.50 by early 24. The feds already told us they think they're going to be a 4.1 in 24'. So we're just arguing a little bit about timing here, not about direction. And so let's price in three and a half to four on the stock market that's why I think you see such lofty valuations lofty relative to ahead of a recession or buying 18 P/Es and a recession that's been largely discounted. We're paying 15 P/E for three year out earnings, which by the way, can be wildly off on those estimates anyway, usually they're way too high. And so I think the answer is because we are anticipating the Feds going to come off and lower rates.

I've argued that the stock market is a liquidity junkie, it wants first and foremost cheap money, and it wants an abundance of cheap money. And we're in a perverse situation in the stock market. As I pointed out, a recession is the most discounted it's been in 50 years according to the Philadelphia Fed survey. Unemployment rates are expected to rise dramatically in 2023. Bloomberg is surveyed stock strategist on Wall Street since 1999 for 24 years. This is the first year the average stock strategist on Wall Street has a decline in the stock market. They did not in 2000. They didn't in the weeks after 9/11 in 2001. They did not in 2008. They didn't in 2009. They didn't even project a decline in the stock market for 2021 after COVID. They are now! Why all this gloom and doom... you usually get fired on Wall Street for being this gloomy and doomy because that's the bull story. The bull story is you're going to pick companies that have good earnings, good management, good products, and then you're going to hope they get blown completely to hell. They have terrible earnings, they have to fire people, they have to cut back because then the Fed's going to pivot and your stock is going to go to the moon, God forbid you buy good companies. And those good companies produce earnings and have to hire people. And oh men, if they have to have such demand, they got to raise prices, Katie bar the door on what's going to happen to the stock market in 2023. Now, obviously, I'm saying this sarcastically to get my point across. This is the upside down world we're in right now, when it comes to the stock market. We need things to go bad to get a good return. If things go good, we're going to get a bad return. And this is how you break markets after 15 years of QE. Because people like I said before, you know, this strategy that's worked is buy SPDRs and wine that the Fed's not doing enough to make me afford a Tesla is that, you know, we need cheap money. And if we have to wreck the economy to get cheap money. That's the bull story. So hopefully people understand that this is not like something we've seen before. And this is where I think the stock market is why are we paying such lofty valuations for the market, because we're anticipating lower rates in the future. If we don't get those lower rates because of recession doesn't materialize, or doesn't materialize faster, we can actually see the market struggle. Now wait, like I said, You mean if things go well, the market goes down. And if things go poorly, the market goes up. Yes. That's been the case of how it's traded all year. Every time we get bad data. You know, good news is bad news, or bad news is good news. That's the way it's been trading. And I think that will continue to be that way.

Erik: Jim, these two big data events this week, the CPI on Tuesday, and then the FOMC press release and press briefing on Wednesday have been widely anticipated in markets to the point that on Wall Street, all eyes for the last 48 hours have been focused exactly and completely on those two events. Except for your eyes. You've actually been looking at some things going on in China in the last 48 hours. What's happening there.

Jim: So China's been under zero COVID. And what happened was they started to get some real pushback from the population about zero COVID. It began at the iPhone factory at Foxconn, where they had some protests. And I might add that 40 people were injured in protest of the factory floor. And as far as my knowledge goes, Tim Cook hasn't said anything about that where they make the iPhones and then it led to there was a fire. Now, people let me paint a visual quick visual for people. Most people in China live in apartments. And most of these apartments you know, they don't have these grand floor with marble, you know entrances and, and you know, velvet couches in the in admin stuff. Their front door is usually a steel door that looks like the side door where you throw out the trash and in a western apartment. If anybody in that apartment tests positive, that steel door is literally welded shut, and everybody's stuck in that apartment. And the government promises that they'll send you food and medicine. And usually they don't if they don't, you're on a diet... tough. There was a fire in one of those apartments and the people were caught in the apartment building we're literally banging on the front door to get out and they couldn't because the door was welded shut because zero COVID and about 10 to 12 people died in the fire. And that sparked a big protest. But the protest wasn't just please end zero COVID. The protest was that the protesters held up white blank pieces of paper called the White Paper revolution. And they were basically protesting about censorship by the government by holding up a white piece of paper, we're not allowed to say anything, and that tells you what you need to know. So these people are not protesting that please, Mr. Xi, please end zero COVID. So I could go back to working at that iPhone factory for 14 hours a day. And maybe you could give me an extra cup of rice if I promised to be a good little worker. No, they want a democratic change. Well, the government heard that. And the government reversed the zero COVID policies, I think in the short term in order to call off the revolution that seemed to be brewing. For the moment, it seems to have calmed people down, but they've almost gone too far in the other direction. The day we're recording December 14, they announced that zero COVID is done, there's going to be no more reporting about COVID out of China, they used to give daily reporting, the number of people died, how many people have positive tests, how many are asymptomatic versus symptomatic. No, we don't need to do any of that anymore because zero COVID is over. But at the same time, anecdotal evidence is very strong, that they don't have herd immunity in China. They're not close to herd immunity in China, because they've been locked down for three years. And COVID is ripping through the population. The hospitals are overrun. People are getting sick. There was a story Tuesday, the day before we're recording that trading in the Yuan, their currency was the lowest since April. And the reason cited was so many currency traders were out sick, that absenteeism is nearly 50% at the dealing houses, that that's why volume is down in the currency market, that there physically isn't enough people there to do the trading that they need to do.

This is going to create all kinds of havoc in China for three years. They were told by the propaganda in China, this is the Black Death, we need to lock you and weld you in your apartment, because it's that dangerous. And now they're all of a sudden going to say after three years of this, that's just the flu, come on out and enjoy yourself. And you could go back well, if you're going to un-weld the front door, am I going to walk out the front door? Sure. Am I going to go back to gathering mass gatherings of people and think about one mass gathering of people is work. Am I going to go back to work as quickly because it is ripping through the population right now. And maybe they'll get to herd immunity in six months or nine months. But it's going to be chaotic. And it's going to be messy. Now give people one metric they can look at. This is available online, it is available on Bloomberg. China still reports daily usage of their subway systems in Beijing, Shanghai in the like. The China Metro usage. Normally in Beijing, the subway in China will get about 8 to 10 million riders a day about the size of New York City. In terms of the ridership, they're down at around one and a half to two. And in the last week or so as they've been lifting COVID restrictions. It hasn't really been rising that much at all.

Now, maybe I'm going to early, you know, check back in two or three weeks. But I think that's going to tell the tale of the tape is after three years of telling people that this is the Black Death. Are we just going to say okay, now it's Tuesday, and now it's just the flu you can leave. And oh, okay, fine now it's just the flu, I'll just go back and continue my life. And we'll have to see whether or not they do. But either way, this reopening of the economy is going to be chaotic. It's going to be messy. It's going to be unpredictable. And let's remember that the protesters were not asking for the end of zero COVID. They were asking for democracy change. And such a messy chaotic opening, could foster more people saying, you know, this kind of way that the government is running things is not right. And maybe we need to change. And so I don't think the last chapter of this book about zero COVID and lifting zero COVID and reopening, has been written. I know Wall Street wants to think that's it, everybody's going to shut up they're gonna get their free extra rice and they're going to go back and make iPhones and make all kinds of other stuff. And they're going to ship us stuff in abundance. And that's going to end inflation here. So Jake, you cut rates and the stock market could go to 5000. I know that's the story Wall Street wants. I'm just not so sure it's going to get it.

Erik: Jim, tell me a little bit more about what was announced today because on one hand, it seems like the white paper revolution was all about the Chinese people demanding more transparency, more honesty from the government. But I think part of what they announced is that they're going to stop reporting the number of COVID cases. So we don't know how many people are getting sick. Is that right? And it seems like that's just going to infuriate the people. If I'm understanding the reason they were protesting correctly.

Jim: No, you're absolutely right. The white purple revolution was we want more transparency, we want more accountability. Now, the government is saying, okay, you're going to get less of it, you're going to get less of it. But you're but we're not going to walk out your door shot and you can go out and you're going to be happy. So there's a disconnect here, between what the government is offering and what the people want. Now, one of the reasons that there might be this disconnect. This is an old story we've not we know this story over time. She was elected for a third term effectively, you know, he's going to be leading China for life. What he has also done, if you remember, the National Party Congress in late October, you know, lays like a movie, like right out of the Sopranos, whereas Hu Jintao was basically escorted out of the room at the same time, is he's purged everybody that would be a dissenter. So she is, is basically like every other strong man who's elected for life or not even elected appointed themselves for life. He is surrounded by yes, men that tell him everything he does is brilliant, and he's wonderful. And, boy, if we could only we're so lucky, we have somebody like you, leading us. This is how they make mistakes. They constantly Misjudged, he is constantly Misjudged between the property crisis, between a lot of the crackdowns on whether it's gaming, you know, how many minutes a day you could do video games, or speculators or anything in between not including and including zero COVID. He has constantly misjudged on his economy. And it seems like what he's doing now with, let's just abolish the let's just abolish the transparency on COVID is going to inflame them. Especially when they see that their grandparents and their parents, and their sick aunts and uncles are basically an overrun hospitals that cannot get proper medical attention because COVID is ripping through a country that never achieved Herd immunity, like most of us have in the West, is only going to further infuriate, I think, a public that's willing to stand up to them in the first place. You got to recognize what a risk and what level of frustration the Chinese people have to come up to, to stand up to stand there and hold sheets of white paper to protest the government. Do not confuse them with the West. That is taking your life in your own hands when you protest that government. And they've been so fed up with it, that that's what they're doing. And if the government's answer is okay, you can leave, but we're not going to tell anybody anything. You're right. I think in the long term, that's not going to help things and probably make it worse.

Erik: Let's talk about the inflation consequences of China reopening because one argument that I've read is, hey, China reopening I mean, it's more demand the economy is coming back Chinese demand for stuff is going to exacerbate the inflation problem. The other side of it is well wait a minute, you know, the source of cheap goods in the world has been China. And it's been the fact that China is offline, that things have cost more. So China reopening is actually going to help inflation come down, which is a Jim?

Jim: Well, first of all, let's remember now that China is in the process of trying to reopen and it's going to be chaotic, and it's going to be messy for the next several months. So there's no immediate reopening right now. And like I said, I'll watch the metro, Metro ridership data and some other things to get an idea of, if people are going to be afraid to leave the house to some degree, it's going to take longer than Wall Street anticipates. But let me take your question. They are going to eventually reopen. I think means two things. I think on the raw material side, China's factory the world, China is by most estimates. I think in Erik correct me if you've heard something different, something like 2 million barrels a day of oil less demanded from China because of various zero COVID policies. Remember, it's a country of 1.4 billion people that have been restricted to staying in their home so they're consuming less energy. And so what you'll see in a reopening is things like crude oil, things like copper, raw materials, they're going to rise. JP Morgan has now got its average crude oil price at 80 bucks in crude oil. Now they think that for all of 2023 is going to average $100 because of what it means for the reopening. On the good side, finished goods. The argument you're going to see there is that there's the supply chain right now is a mess in China. 1/3 of all container are those 40 foot box containers that are exported to the United States come from China. And the problem with China is, even though maybe 20 to 25% of the country is in some form of restriction, or lockdown that in a zero, in a just in time zero inventory world, I rely on somebody to produce something to produce something for somebody else that I need. And if somewhere along the line, one of those pieces in the chain is in lockdown, the whole chain stops. So even if just 20% of the country's locked down, effectively 100% of the country is disrupted because of it.

And so once you get past that, and you get the supply chain operating properly again, you could see a ramping up of goods. Wall Street, I think miss judges a statistic. They look at the shipping rates out of China, what does it cost to send a 40-foot container box from China to the United States. The beginning of the year, it was about $15,000 a box roughly. Today, it's roughly about $2,000 box at the pre-pandemic levels. Oh, that's it, inflation has been canceled is what you hear from people know what that it's a sign of is how chaotic and unreliable manufacturing is. They can't produce stuff. And the World Trade Organization does actually do a trade production measure that is showing that that production out of China is down and down a lot because of these chaotic processes that zero COVID and other things have, have fostered on their economy. And so the reason that shipping rates are down is that these big ships that take containers are not just going to float off the coast of China waiting for something, they're going to cut their rates to get a cargo now and that and so it's a sign of their weakness. If China is going to ramp up to get production going by say the second half of the year, we back up to what we talked about a few minutes ago. That could be right at the moment that the US is experiencing a slowdown. And all of a sudden we're ready to go, we're ready to start making stuff just like it's 2019. And then their US suppliers are going to say we don't need it, because we got to slow down right now. So they're going to perpetually stay out of sync with the rest of the world. They have been since COVID. It has shown up in their economic statistics, their GDP numbers have been some of the worst since they started reporting GDP in the late 70s. And I just don't see it getting better right now.

Erik: Jim, let's move on to the gold market. You know, as a gold investor, it's easy to pat myself on the back and say boy, the returns have been fantastic for the last couple of months. But frankly, I can't put my finger on what the real driver is because something changed dramatically on November 4, when we saw just a huge move up in gold prices and the beginning of a monstrous $200 plus rally. Now, that data came out before the November CPI print. So you can't attribute it to CPI unless you think somebody had the number at least a week ahead of time. All right, several days ahead of time. The CPI helped it and that really seemed to take things higher. But we had another miss just yesterday on CPI, and it came in below expectations. And gold was up but nothing close to what it was last month. So some people have said no, it wasn't about that, it was about Central Bank buying. And that makes sense to me. China has reported for the first time in years, an increase in their central bank gold holdings. But hang on that story, I think really would have been ignited by the seizure of Russian FX assets that was more than six months ago. You know, why would it suddenly happen November 4, I feel like I don't really understand what's driving this rally. And that scares me because it means I don't know when it's going to end.

Jim: Well, a couple of things... November 3 was also the high yield in the bond market. So everything kind of turned at the same time. And around November 8, just a couple of days after that was when the dollar started to turn down. So you had gold turn up the dollar turned down and yields peak all within a week of each other. I know I said this when I when I last talked to you is that the biggest problem with gold is well first of all, what role do we understand gold that is supposed to traditionally play. When you are a worried about the health and the stability of the financial system, whether it's inflation or financial crisis, or something along those lines. How do you get your money out of the financial system? Well, you really can't, but the closest you can do is gold. Now that still sort of applies, but it only applies if you are willing to buy a sack of gold coins and bury them in the back yard or own warehouse receipts in a foreign country outside the reach of your tax man and your governmental authority, yeah, that's hard to do. No one knows how to do it. So we financialized gold. Oh, no, look, you could buy options. You could buy futures, you can buy ETFs. We've turned gold into another fiat currency. I know Peter Schiff doesn't want to hear it. But we've turned gold into effectively, another Fiat and it trades like another Fiat. So when the dollar was rallying, it was suffering, like all the other Fiats were suffering and interest rates were going up now that rates are going down and the dollar has turned, and the dollar has been weakening. I think that gold has been rallying like all the other Fiats have been rally.

Now, is gold, something different than the Fiat? Yes. But so many people, I can't tell you how many people I've met, oh, I own gold just in case. And it was like, well okay, how do you own gold just in case? Well, I own some GLD. And I was like, I got news for you, if that just in case happens. Your GLD is a worthless piece of paper, it is not actual gold. And now another story has been hitting lately. And that is that China desperately wants the end of the dollar as the reserve currency. Yeah, I get it. They do. But you know, by there's no alternative. TINA, that is the ultimate TINA, there is no alternative. Maybe someday there will be, but there isn't now. And they floated the idea of using gold, or won gold to basically pay for trade. Oh, well, then we're going to have to acquire gold for trade. Now that's a story. But you know, in a market full of Degen, short term traders, that's enough to just get them excited, as well. And we've seen a little bit of a pop and gold a couple of weeks ago, right around that story. But I think the major thing is, it acts more like a Fiat than anything else. So when the dollar weakens, and Fiats rally, gold rallies. And when the dollar strengthens on the on the back of higher interest rates, it sells off.

Erik: Jim, based on all that, do you think that this gold rally is topping out or is it to still have a long way to run?

Jim: I would say at this point that it's probably closer to topping out than anything else. Because if I'm right on the idea that while we may see a slowdown, it's going to be longer than we think. Markets are going to get disappointed, we're going to see higher interest rates that I think is the primary driver of the currency right now. That means maybe we're going to see a low in the sell off of the dollar and the dollar will start to strengthen. And then gold will get a little bit weaker as we move forward from here on. I'm not suggesting you know that gold is going to fall apart. But you know, it could pull back in the middle of its range, which is roughly what about 1600 to about 1850. So you know, it could pull back 100-125 bucks into the middle of that range. But I'm not ready yet to think that gold is going to take off because I again, view it as a Fiat if it's going to go, I think you know, if we have $2,500 on gold, it's going to go with the other Fiat is going with it. If you think we're going to have $2,500 of gold or $3,000 of gold, because you know, and I'll use the technical term here is that everything hits the fan, then you don't want to own GLD. You don't want to own futures. You don't want to own options. You want to bury coins in your backyard. And again, no one does that. It's too hard. They don't know how to do it. They don't know where to buy it, they're afraid it's going to get stolen. They'd rather buy GLD well, as long as that mentality exists, and it still stays Fiat. It's going to act like a Fiat.

Erik: Well, Jim, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners a little bit more about what you do at Bianco Research and how they can follow your work.

Jim: So Bianco Research is an institutional advisory business. In other words, we publish research for institutional investors mainly in fixed income and in the macro space. Find out more about us at our website biancoresearch.com. It is an institutional product, which means it's a little bit pricey for the average retail investor. But I do try to keep active on social media @Biancoresearch is my handle. I would say I am like a lot of other people in the financial space. I do have a lot of accounts that spoof me that try to get you to sign up for the wrong account, and then trying to ask you for money. It bothers me that my name and image is being used in that way. So I like to warn people I will never ask you for money on DM. If somebody does, it is not me, make sure it's the one with the blue checkmark and it's got the high number of followers. If it's somebody with a few 100 followers, it's somebody that's spoofing me. I can't tell you how upsetting it is when you hear that people are being taken by something like that. You can also find me on LinkedIn to at Jim Bianco.

Erik: Jim, I really appreciate your bringing that up and listeners, we've got the same problem. There's a @MacroVoices__ account and there's a @Macr0Voices with a zero instead of an o in the macro. Be very careful that you don't get taken by fake Twitter accounts with Twitter in reorganization right now, they're not doing a very prompt job of getting rid of the impersonator accounts, and it's really having a strong impact on everyone. Patrick Ceresna, Nick Galarnyk, and I will be back as MacroVoices continues right here at macrovoices.com