Jeff Snider: Soft Landing or Crash Landing?
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Erik: Joining me now is Eurodollor guru and Eurodollar University founder Jeff Snider. For anyone who’s not familiar with Jeff's work, he is known for his terrific graphs, charts, and slide decks. And this week is no exception. So be sure to download Jeff's slide deck to accompany this interview. Registered users will find the link in their research roundup email. If you’re not yet registered, just go to our homepage at MacroVoices.com. Click the red button above Jeff's picture that says "Looking for the downloads."

Jeff, it’s great to have you back on the show. Before we dive into the slide deck, I just want to start with the high-level picture because inflation is on everybody's mind. We’ve had a number of people who have expressed this transitory view that basically inflation was entirely about supply chains and the pandemic ending. It was a flash in the pan, it’s all going away, and we’re headed back down to 2%. There have been some other guests who have said, “Well, wait a minute, we’ve got a new inflationary trend. Reshoring of critical industries is going to be inflationary. There are other secular inflation causes that are going to allow us to come off of those high numbers after the pandemic, but we’re not going back down to 2%. We’re going maybe down to 4% if we’re lucky.” Then just last week, we had Alex Gurevich say, ”No, forget about 2%. We’re going negative. We’re headed into a deeply deflationary event.” Now, the last time we had you on, you said, “Well, it’s a little more nuanced than all of that. The price increases are probably likely to continue, but it’s not monetary inflation that’s causing them.” So this is all kind of a big jumble in my mind. Before we dive into the slide deck, just give me the big picture rundown. How should we be thinking about inflation now in these post-pandemic times?

Jeff: Yeah, well, first of all, thanks for having me back. I always look forward to coming on MacroVoices and chatting with you because we get to talk about all this interesting stuff because we live in such interesting times. And I think that is probably the big question on everybody’s mind. We went through a consumer price shock that lasted probably longer than most people were expecting, myself included. And now, maybe we’re seeing some progress in it, but what really comes next? Is it just a transitory disinflationary period? Are we going to see long-run trends rise well into the future? There’s, I think, enormous questions and uncertainty, I think it’s certainly in the public mind about what really comes next. Now, let’s see CPIs starting to come down a little bit. I like how you said that my view is usually more nuanced, because usually, over the long run, the way consumer prices behave can be very different from one time to the next. But as you already pointed out, from my view of the monetary perspective, that kind of precludes long-run secular inflation, because we still don’t see the type of money excess that you would need or require, in order to lead into something like the 1970s all over again.
Because really, that's all inflation is, genuine inflation is nothing more than excessive currency creation, chasing too few goods.

I fall into the camp where you, and so many others, think about consumer prices over the last couple of years as being transitory because they were due to simple economics, where demand shifted, in part by government intervention, went further than supply could service. Therefore, again, simple economics, prices had to adjust. But in adjusting to higher prices, it creates this continuity in the overall macro global economy, which has to be worked out one way or the other. Either, the economy has to come roaring back at some point to allow for consumers and businesses to pay for these higher, especially basic necessity costs. Or those higher prices will be the cure for the higher prices, because eventually, the economy will have to fall off because of too much activity being redirected to the least productive parts of the system. And I think that's what we're seeing right now. We can get into the slide deck for it, but big picture, in general terms, it's I don't see anything that looks like the 1970s. In fact, this is a question going back to the 1970s that officials and economists had wrestled with at the time. And I always use this quote from former Federal Reserve Chairman Arthur Burns in August of 1971, that quite auspicious month back then, where he recognized that, you know, okay, we had consumer price increases, we had genuine inflation up until the recession of 1970. And then everybody expected that the recession would tamp down on those consumer price pressures. And after we got through the 1970 recession, that would be the end of the whole affair. But that's not what happened. And so in August 1971, Burns testified to Congress. He said, "A year or two ago, it was generally expected that extensive slack and resource use such as we've been experiencing would lead to significant moderation in the inflationary spiral. This has not happened either here or abroad. The rules of economics are not working in quite the way they used to," except he was wrong. The rules of economics were working fine, what he was missing.

I think what a lot of people are missing today is the underlying monetary issue. Burns and the Federal Reserve back then, they had no idea what was going on in the Eurodollar system. They really didn't have much idea what's going on in the banking system, either except that the banks were making tons of new loans all the time. And that was what was creating the next wave of what will become the great inflation. But without that monetary expansion in 2022, into 2023, we should expect, as Burns was in '71, that if we do have a recession this year, and I believe we will, that should be enough to reduce the supply shock pressures and bring consumer prices back down. But the question is, what does that mean? Does it mean that consumer prices or the CPI goes back to 2%? As you alluded to? Or is there a little bit more nuance there, where consumer prices might fall a little bit as we go through maybe a deep recession, and then come back up to more of a lower and disinflationary level in between? I think that's the major question that we really should be wrestling with right now.

**Erik:** Well, let's go ahead and dive into the slide deck, which is titled "The Landing". Now, just the title makes me curious, because a lot of people really thought by now, you know, once we get past the first of the year, we'd be in a deep recession, but a lot of people are starting to say maybe the Fed has pulled off a soft landing. I'm skeptical of that view. But it doesn't seem like
we're in the deep recession, the painful recession that a lot of people thought we'd be in by now. So, have we achieved some kind of soft landing otherwise?

**Jeff:** I don't think we can say for sure. I think our suspicions are well-grounded for a lot of reasons, which we'll get into here. But the question of whether we're in a soft landing or a hard landing is, as usual, a difficult one. During these periods when we transition from expansion to contraction, it's not a continuous, smooth, incremental process. It's actually very difficult to tell one from the other. At some point, the economy may look like it's entering a soft landing, but then it may keep going into a recession. The economic and macro data during that period can become very confusing. One day, you may get an economic report that suggests a nasty recession, such as we saw with imports and spending falling in the US in November and December. But then last week, we got the huge payroll number in the US, which may suggest a soft landing. During these periods, we don't have a clear sense of the data, especially in terms of which suggests one or the other. All we can say for sure is that the economy is slowing down, and that means we need some way to guide us and tell us which is which, which is what we'll get into here. But a lot of people have gotten the sense that this disinflationary period is transitory. The reason is because either the Fed has engineered a soft landing or the global economic system has been resilient enough to not suffer a major recession. The German government recently said that people were expecting a nasty recession, but they don't see it, and they're forecasting 2023 to be a mythical soft landing where there won't be a contraction in GDP. There are three things driving people toward the soft landing viewpoint. One is that Europe has avoided the worst-case scenario, which was last year when electricity prices were going to go through the roof, which they did, and then continue to go through the roof would just decimate the German economy, the European economy as a whole, things might go further wrong and Ukraine, leading to really some bad scenarios. So those didn't happen. At least, you know, the worst case scenarios because electricity and energy prices tended to fall. But then they fell through the end of last year, which has got a lot of people thinking that Europe has avoided the worst-case. Second, the US economy seems to be resilient, as shown by the payroll report for January was exceptional, though maybe a little bit too exceptional to be believable. But either way, even you look at some of the other jobs data, it's not clearly into major contraction territory would suggest maybe the economy's hanging in and the third thing of course, is that now China is now fully reopening, which will provide another boost to the economy.

So if we go to the third slide here, the first part before we get into any of those other three issues, we have to consider that consumer price pressures are abating, because unless we have falling consumer price increases, so second derivative, not necessarily falling prices, but slowing consumer price increases, it'll be difficult for any economy to weather that type of headwind, which will mean that if consumer prices don't prove, or this disinflationary trend doesn't prove to be transitory, it will jeopardize the soft landing, because it will mean that whether it's the US economy or Europe, or wherever it happens to be, they'll have to suffer from more consumer price and producer price pressures, which will lead to potentially a recession. So when we look at slide four, going forward, slide four, five, and slide six, what you see in the United States is exactly what Jay Powell had said at his press conference in early February,
which is that for the first time, they think disinflationary processes have started. And we can see that really in goods prices, and yes, the US CPI has been decelerating, and it hasn't been falling in the past couple of months, it's been declining. But there was a big change around July. So last summer, we see, of course, coincident with oil prices, consumer price indexes, including the core CPI when you adjust for owners equivalent rent, there was a big change in consumer price behavior around June, which raises the important question of what really happened back in June and July that would cause consumer prices to start to decelerate. And I don't think it was the rate hikes from the Federal Reserve or the ECB or anywhere else in the world, because even proponents of rate hikes would tell you that rate hikes take some time to have that kind of effect.

And what we saw was almost an immediate effect, which to me suggests that something changed inside the actual economy that had nothing to do with the Federal Reserve, which is one reason why we might look at falling consumer price gains or slower consumer price gains with a little more suspicion than you would imagine from a soft landing. In other words, what if consumer price increases are declining because the economy is actually struggling, rather than because the Federal Reserve or another central bank has engineered a soft landing? And we look around and it's not just in the US, we see this shift in behavior in consumer prices in a lot of places around the world. Slide seven and slide eight just present a couple other examples. On slide seven, we have the French Consumer Price Index, which hasn't come off the same way that it has in the US and other places, but still, you can see a marked change in behavior around July. One big one for me is Germany, where consumer prices continued to accelerate until October, but you can see in other places, whether it be producer prices or wholesale prices, something changed around last summer. And again, slide nine, the quote I mentioned before, the German government looks at falling consumer price indexes or rates of change. In second looks at as this is the best possible case that consumer price pressures are falling, which will lead us into a soft landing. Whereas you look at some of the markets, which is what we really think we really need to focus on how markets are looking at all of these macro developments and pricing the probabilities based on those.

And if you go to slide 10, look at the German federal securities market, which is the bond market, the German equivalent to US Treasuries. And again, you see some pretty substantial changes going back to last summer. Again, in the middle of June, we saw the German curve start to flatten out and rates started to fall a little bit. And then, even as the ECB was hiking rates, in particular October, the German curve radically shifted in a way that we have never seen before. This is an unprecedented inversion in Germany, which already raises some alarm bells here. Because, as we know, inversion is usually associated with more of the bad types of macroeconomic and financial outcomes than a soft landing. Not only that, what's interesting is that the shift in the German curve happened at the same time as what we see in other curves, including US Treasuries and Eurodollar futures, which we'll get to in a minute. But especially, the inversion really went nuclear when the US reported its October CPI, which most people will remember as the data that kind of kicked off this disinflationary wave throughout the marketplace.
The idea was that with the October CPI, we could really clearly see that consumer price pressures were starting to abate. And, rather than seeing that as a positive, in Germany, the same interpretation of consumer price pressures was made, but for what had to be very different reasons. We go to slide 11, and on slide 12, you can really see how the German curve has changed over those couple of months. This is an absolutely unprecedented inversion in that marketplace, which can't be a good thing. When you see curves invert, that's not really a good thing, but to the degree that they have in Germany, when Germany is supposed to be the most boring, uninteresting market there is, yet now the curve looks a lot more like US Treasuries or Eurodollar futures than not. To me, that tells me that there's so much hedging demand in that area because participants in the marketplace are thinking about not a soft landing type of outcome, but really need to hedge against some of the worst possible cases, even if we don't see it just yet.

But if you look ahead to slide 13 and 14, I could have added more data points here, but I think these couple here really make the case. Even though the German government forecasts no recession and has become much more optimistic, the same week, they made that forecast, they also reported some pretty terrible economic numbers. You see that both nominal and real retail sales in Germany absolutely collapsed in December, which is consistent with what the market was saying back in October and November by turning into this unprecedented inversion. So, the market may have been onto something where the German economy, at the very least, has suffered a severe stumble in December. The same thing can be seen in German trade.

On slide 14, we have a massive contraction in exports as well as imports into Germany. What's interesting about this is that German exports to the US and China, its biggest customers, were down the most, and then they were down really substantial numbers just from November. So, from the German perspective of Europe, avoiding the worst-case scenario, the first bullet point of our soft landing fever, I'm not sure that's the case because it might be that now the macro data is starting to pick up on what was a more serious contraction in that economy. Just today, we got some more data, including German industrial production, which was down big in December, and in factory orders, even though factory orders rebounded in December, they were mostly about aircraft, large-scale orders, and underlying the volatility of factory orders, even though factory orders rebounded in December, they were actually mostly about aircraft, large-scale orders and underlying the volatility, factory orders which were down hugely in November, were down again in December. So maybe we jumped the gun a little bit here on saying Europe avoided at least a recession; maybe it avoided the worst-case scenario of an electricity crisis, where if people can't heat their homes, that type of really big catastrophe. But that doesn't mean that Europe and Germany have avoided all downside and negative cases.

**Erik:** Let me ask you a question about that, Jeff, because the way I see it, we're kind of in a "calm before the storm" moment here. At least that's what I think it is, where we had Europe in an energy crisis moment that has mostly come under control now. And I think it can stay under control as long as economic demand is suppressed. But the thing is, what's different this time is the usual safety buffer mechanisms. You know, if you get a sudden increase in the economy and industrial activity picks up, what happens is OPEC has plenty of spare capacity. They see
the data coming, they start to turn the knobs up and produce more oil. And you've also got the huge global commercial inventory system, which acts as a buffer that you can draw against. Well, we have a situation now where OPEC is out of spare capacity almost completely. Saudi Arabia and the United Arab Emirates are the only two countries left that still have some spare capacity, and they don't have a whole lot. Meanwhile, inventory has been drawn down to generationally low levels in both commercial and strategic petroleum reserves. So the buffer mechanisms to absorb an increase in economic activity and increased demand for energy just aren't there.

So that sort of sets the stage for there could be another really big energy crisis moment. But at the same time, if we're about to fall into a global recession, an echo of the pandemic, well, that's going to reduce demand and that will delay this moment of reckoning in energy. The markets that I'm predicting potentially for a few years. So if you accept that basic premise, that we don't really know what's going to happen, and we can keep energy prices under control as long as demand doesn't pick up. But the system is unable to absorb a significant increase in demand because there's just no supply to meet it. How does that affect your analysis?

Jeff: I agree with you, I think that's really the consideration, but not not for this year. But there's something down the road. And so the inability, the rigidity of the energy supplies and really other forms of commodities, too. I think that's going to plague the recovery after we get through this next year, which likely will be I think, a recession. And so that will keep a lid on the ability of the economy to rebound from that one. So we'll have even more problems to worry about after we get done with it. But I think what the German curves are telling us now the German data as well as European data, you look at European retail sales, they were horrible, too. I think the damage has already been done. I think the damage from the energy crisis last year, eroded enough of the European and really the global economy's ability to spend and businesses to hire at all the basic economics that must happen. I think that the damage was already done. And so what we're seeing here now is the delay from that damage, finally working its way through, out into the open or at least more open. So going back to what you said about energy and oil, I do think demand will temporarily fall enough to keep prices and energy and other commodities relatively behaved. For the time being. Again, I think that then it becomes a issue a bigger issue. When we get through the recession, however long this might be, depending on what the what it ultimately looks like. Will it be short and sharp? Will it be shallow and prolonged? Will it be deep and prolonged? But I think yeah, you're I agree with you, Erik, on the other side of the recession, there's going to be still these problems where we have to reckon with ridiculous supply constraints, which really shouldn't be an issue. But here we are.

Erik: Let's go ahead and get back into your slide deck then. Page 15, you're talking about Jay Powell saying, given his outlook, he doesn't see rate cuts this year. Does that mean he's done hiking? Is this a signal that the hikes are over and it's a question of waiting until it's time for rate cuts?

Jeff: I don't think Powell knows for sure. Even if he does have an idea, he's certainly not going to tell anybody in the public. But I think he, I think the Fed is preparing for reaching its terminal
rate. But then they want to make sure that everybody knows just because they might stop hiking after maybe the next meeting. Or maybe they're done already. Who knows what depends on how things develop. He doesn't think that means that rates are going to go down immediately. Because in his in the Federal Reserve's and most mainstream base cases, we've reached a soft landing, the Fed has achieved its goal, consumer prices are starting to round up and roll over, heading lower, the economy seems to be resilient, at least in terms of some of the employment numbers like the unemployment rate in the establishment survey. So as far as the Fed is concerned, if their outlook comes true, and you have to agree with them here, if that outlook is true, there would be no need to cut rates. But the problem with that is when we look at these markets, I already mentioned the German market, which is heavily inverted, unprecedented inversion, which speaks about the future direction of yields going lower. And if you go to slide 16, and the next few slides here in the series, you'll see that the US dollar markets are all doing the same thing too, including something that Jay Powell pointed to last year. If you remember back in March, the US Treasury yield curve between the two-year and ten-year (the 210 spread) first inverted last March. And Powell said no, we don't pay attention to long-term rates because they're affected by supply factors and all this other minutia, meaning that we can't look at the yield curve, it's all spoil. Instead, we look at something called the near-term forward spread, which is nothing more than comparing the current three-month rate with what the market expects the three-month rate to be six quarters ahead or 18 months. And the near-term forward spread back in March was relatively steep. So he said we don't see any problems ahead.

But fast forward again, we see that October CPI showed up in the near-term forward spread, just like it had in Germany, with the market looking at that CPI and saying consumer price pressures are likely coming down, but likely not for good reasons. And if we take the near-term forward spread rather literally, what it means essentially is that the market is expecting three-month rates to be lower six quarters ahead than they are today. And in the course of January heading toward February, the near-term forward spread collapsed to a level that we haven't seen in a very, very, very, very, very long time. It's even worse than it got to be at the worst part in 2006 and 2007. So the market looks at Jay Powell's statement saying, I don't think rates are going to come down, and the market says, well, there's a very high probability that, at least according to the near-term forward spread, six quarters from now, rates will be substantially lower than they are today. And if you look at slide 17, which is the US Treasury curve, again, just like the German curve, you'll see a big shift in June and July, coincident to when CPI started to come down. Another big shift in November and December, particularly with the US CPI in October. And then another major shift in January, which is more and more inversion on these curves, meaning the market is more and more certain, sorry Jay, that rates are likely to go lower. And we can continue to look at all of these markets. Slide 18 just looks at the curves, you see how the US Treasury curve and the German curves look too much alike, which is very concerning. Slide 19, Eurodollar futures, again, we have that shift originally around May, June, and July, then another one in November and December, and then again in January. Eurodollar futures are quite literally being used by the market as a hedge in a way that will pay off when rates go lower in the future.
So, market after market, it's not just treasuries, not just the yield curve, which was huge. In Germany, we see it in Canada, in any number of markets around the world that are heavily inverted, which suggests that Jay Powell has got his outlook and forecast wrong. We agree that if his outlook comes true, there would be no need for interest rates to go lower. If the economy was in a relatively good place, both here and abroad, no central bank would need to cut rates. Yet every market is priced as if rates are going down, which raises the question, why? What is going to force central bankers to lower rates or yields to go down on their own, regardless of what central bankers do? Usually, those things go together, usually rates start to go lower, and then central bankers follow along afterward, because they are always reacting to what is going on in the economy. If you go to Slide 20, the markets must be ignoring the January payroll report, because the report was huge and made it seem as if the US economy is doing really well, if not too well. The Federal Reserve and Jay Powell probably looked at it as an outlier and didn't put too much stock in it, which is why they made their statements at the press conference, likely knowing ahead of time that the payroll number was going to be good. High-frequency data tends to be noisy. Going back to last July, we had a +500,000 month, but we don't remember that one because the labor market continued to slow. The establishment survey projects the best-case scenario and throws out the January number. The labor gains have been slowing down to begin with, but then you look at some of the rest of the data, including the household survey for employment.

Adjusting for the population control factor and some of the statistical stuff that gets thrown up every year with benchmark annual revisions, what you see is that the household survey has been behaving very differently from the establishment survey. The picture of the labor market from the household survey looks like the beginning stages of a recession, whereas the establishment survey looks like everything is fine. This huge discrepancy is even within BLS data series, where one looks like what the markets are pricing, and the other looks like what the Federal Reserve wants it to. The most important part is the household survey for full-time employment, because before we get into any actual contraction, companies will be careful. They'll see a small drop in demand and revenue, slightly less profits, and won't respond immediately by firing all their workers. Instead, they'll start managing their cost structure more carefully. They may institute hiring freezes or cut back hours from some of their existing workforce. You might see the level of full-time jobs not but it does tend to start growing in in the case of last year, right around April, which was when we had the first initial after the first initial energy spike, which probably caused a lot of businesses in the US and global economy to look at their costs and say, with these higher energy prices, can we afford to hire new workers? But do we have to start cutting back on our activities? And according to the household survey, the answer was decidedly Yes.

And if you go to slide 23, also, what you see is that. This is generally what happens before each recession. The level of full-time jobs, which was expanding beforehand, doesn't immediately shift into contraction. It goes through this multi-month rollover process where businesses stop hiring and cut back on their hours before they start letting go of lots of workers. And it has followed the recession path almost to a tee over the last year. which again, is consistent with what we see in the marketplace. Whereas if it continues to follow that pattern, we should start to
see over the months ahead, where businesses have finally thrown in the towel and said, We need to start really cutting workers because, you know, we were careful, we held the line on jobs and cut back some hours. But the economy is not getting better. Our revenue and profit prospects aren't really improving the economy overall is, quote, unquote, too uncertain for us to continue with this way. So eventually, unless the economy actually does start to come back, businesses will eventually start cutting workers. This transition from expansion to contraction is not all at once, but usually it's this multi-month process.

**Erik:** Now, let me ask a crazy off-the-wall question here. Because what you're saying is that the markets are discounting lower interest rates. What I'm about to say is definitely not my view. I'm just trying to be a good interviewer here and cover all the possibilities. Isn't there a case? If you really believe that the Fed has achieved this soft landing, that says, "Okay, well, what's going to happen is the Fed will succeed at completely containing inflation." Without inflation, there's no need to keep rates up. There's no recession coming. But we'll be able to lower rates despite the fact that there's no recession, because the Fed, with Jay Powell wearing his Superman T-shirt, has successfully tamed inflation and made it go away.

**Jeff:** Yeah, and I think that's the long-run view of the Federal Reserve too, is that when you look at the dot plots and all of the forecasts that come out of their longer-run projections, what they say is the longer-run neutral rate is only ticked up a little bit higher in their estimation compared to where it was before 2020. So eventually, that means that rates have to come down to meet their long-run average. But that's not what markets are pricing here. Markets are pricing rates coming down far sooner than Jay Powell and the FOMC is projecting the dot plots. As he said in his press conference, he doesn't see himself cutting rates this year, while Eurodollar futures and other markets do. In the near term, we even see this inversion in the Treasury curve, where the six-month yield is above the 12-month yield. So there's more, there's a greater probability priced into the markets right now that rate cuts will happen before the Federal Reserve is willing to do them. That can't be the natural progression of yields and rates to their longer-run average. That means something interrupts that process. Because remember what Jay Powell has said, the FOMC has been absolutely clear about this. They want to hold rates where they are, wherever they get to the terminal rate, they want to hold them there as long as they possibly can, in order to ensure that, according to their model, the economy and consumer price pressures really do leave. And the markets are saying something will happen before that time that will cause them to rethink that stance.

When we look through all of this economic data, you can see why markets are predicting or forecasting that the chances of a premature, involuntary rate cut regime would be consistent with what you see in full-time jobs, for example, because in full-time jobs, you see the economy rolling over toward what looks to be a recession, with curves as heavily inverted as they are. Again, we haven't seen this really since 2007, and in some cases, some parts of the curves, we haven't seen this since the 70s. They're really saying that the range of potential scenarios moving forward starts to look ugly. And again, I think a lot of the data suggests what markets do, but you still have this gray area, ambiguity, and confusion, because not all the data is in agreement, like the payroll report, and some other accounts too, which suggests well, maybe
the economy is doing fine, and it's not really until all the data moves in one direction or another that we can say for sure what has happened. Remember back in 2008, the NBER, for example, the Economist group, who took it upon themselves to officially declare a recession and recovery, didn't declare the Great Recession a recession until December of 2008.

That was months after Lehman Brothers and all that. And what they said was well, they looked at the employment data, and the employment data was fine until around September. I mean, it wasn't good, it looked like the economy was slowing down, it was experiencing some trouble, but it wasn't until the summer of 2008 that we could really see clearly that we were in a recession. And the Federal Reserve, everybody else was in the same agreement. If you look at the transcripts in 2008, the June transcripts in particular, the forecasts were that the US economy would avoid a recession in the middle of 2008. They were still optimistic that the economy would avoid a recession, that markets had already predicted, priced, and anticipated the year prior.

_Erik:_ Okay, and what we're seeing in this case is the Fed is anticipating a victory with a slow and gradual return to lower rates because they have succeeded at taming inflation. But you're saying, yeah, but the market is predicting a panic, later this year. And it's not about declaring success and victory. It's about a recession that forces a panic rate cutting cycle to begin before the year is out.

_Jeff:_ Yes, some form of involuntary aggressive action, because that's what markets are really priced for that sort of probability. Okay, the level of inversion again, I think it precludes the idea that the economy is going to gently sail into a soft landing, we're all going to be celebrating Jay Paul's skill and acumen that doesn't seem to be in the cards, nor does it seem to be in a lot of the data points, especially some of the key forward-looking stuff, which again, we'll get back to the slides on slide 25. I think the ISM, which is one of the ones a lot of people pay attention to for good reason. It's one of the oldest ones around, in particular, the new orders number, we know we have an inventory problem globally, which is a bigger problem than it usually is historically, because of all the supply chain issues over the last couple of years. Now we see that the index, the headline index, as well as the new orders index is really in not just recession territory, but also solid recession, nasty recession territory, which is going to spill over not just in the US manufacturing economy, but also the services economy as well as producers overseas, because of how much Americans in particular fell in love with shopping on Amazon.com, which a lot of those goods that were bought on Amazon were shipped here from overseas. So this is going to spill over globally.

And you look at slide 26, a lot of data on the services economy in the US suggests that we're already in a severe recession and where, Erik, where have all of the layoff announcements come from? That's another thing. We keep seeing, yes, the establishment survey and the payroll report looks fine. But we keep hearing about all of these layoffs from some of the biggest named companies. Yes, anecdotes are not data, and the plural of anecdote is not data. But there is a solid, solid number of indications that show the services economy is experiencing an unusual level of weakness, which we see in some of the surveys. The ISM non-manufacturing
survey seems to be an outlier, but even there, it’s a relatively low number. Look at some of the Fed regional service surveys for services. And what I’m saying is that there’s a broad consensus, maybe outside of a few data points, which look more like what would lead the economy into a situation what markets are predicting and pricing. There is a consistent message here in the US as well as Europe markets, which are leading in the economy, and the data are eventually following along.

Erik: I love the pictures on page 27. What just happened to Xi Jinping?

Jeff: Well, I think it was a, I mean, I don't know if we'll ever know for sure. But it seems to me it was a very much scripted, planned event as much as it was supposed to be this random, random health problem, as the government said. I think it was Xi Jinping really cementing his legacy, symbolically having the baby of the last president who was symbolic of the Chinese Communist version, which embraced global liberalization, having him forcefully removed or escorted out of the party congress, which is all about show to begin with, was him saying this is a new China politically, economically, socially in a lot of different ways. And it's not just a new China in 2022. This has been coming for a long time. The trend toward this type of one-man rule started way back early. It was really cemented with the 19th Party Congress in 2017, which, if you recall, the Chinese said, we're doing the economy differently here. We're doing quality growth rather than quantity growth, which has led to the 2020 introduction of Xi's common prosperity mandate. Which, getting back to our original discussion here about soft landing fever, is the political backdrop for China's actual economic priorities. Unlike under Hu Jintao's regime, you're not going to see the Chinese respond to economic weakness with textbook Keynesianism.

In fact, we have seen that the Chinese economy has been especially weak over the last couple of years, regardless of the pandemic and policies. Their underlying economic structural weakness means that we haven't seen the types of responses that we did in the past. So if the idea is that China removes its zero COVID policies, which will unlock and unleash its potential, I think many people are going to be disappointed that that potential might be a lot less than maybe hoped for. If you go to slide 28, we don't have a whole lot of data just yet about the full reopening of China. We just have the January PMIs from the NBS, and they look really disappointing, because they look a lot like when Shanghai reopened last year, which obviously didn't amount to much anyway. And what I think is more important and potentially more of a factor moving forward is that last year, when Shanghai on the east coast was reopened, the global economy wasn't in as bad a shape as it is today. So it might be that the global recession that's developing here and abroad, and in Europe and other places, actually has more of an impact on China than China reopening might have on everywhere else. You see that in the PMI data, for example, in the new export order components for both the non-manufacturing and, on slide 29, you see it in the manufacturing PMI. And even the manufacturing PMI headline isn't all that great either. So it may be that China reopening turns out to be more of a disappointment like it was last year and doesn't contribute to the sort of economic activity that would help the rest of the global economy avoid a recession.
And as you go to slide 30, just finishing up here, Chinese exports to its biggest customers, the US and Europe, fell dramatically. Again, we see this in November and December, just as the curves were shifting to greater inversions, which again suggests that demand for Chinese-made goods has fallen off sharply, which will hinder Chinese reopening, however good that might have been otherwise. As I said, the global economy may hinder China more than the other way around. And then just one final market curve, which has got me fascinated and focused, is the oil curve WTI in the US. No matter what happens up and down over the last couple of months, as you can see on both slide 31 and 32. You can't shake this contango, which really, I mean, given as Erik pointed out, the tight level of supplies and low level, ridiculously low levels of inventory. Yet, we have these curves incentivizing more oil to go into storage, which to me suggests either fears over liquidity or fears over demand more than anything. This just wraps up the entire presentation here. All of these markets, as well as a good chunk of the data, suggest that maybe we haven't avoided the worst-case scenario, and maybe we're not heading toward a soft landing. And if it looks like we're heading toward a soft landing, that's just because recessions often look like soft landings until they don't.

Erik: I want to come back to China for a minute because my view until recently had been, "Okay, we're not sure exactly of the timing. But at some point, China reopens completely. They are a huge economic engine; they consume more oil than any other country on the planet, including the United States. It's got to be a big deal when China reopens, and surely it's just a matter of time." Well, when I first started developing those views, that was before we had US generals announcing to their staff in very public ways that they expect to go to full-on hot warfare between the United States and China by 2025. There's a big difference between China, the engine of economic growth, reopening and going on to resume its usual role of supplying the entire world with cheap stuff, to China reopening to face a war with the United States. So what's going on here? Personally, I don't really understand the rationale for why there's so much intensity, at least in the current political administration in the United States, toward aggression toward China. But it seems like there is. Is that what's driving this change in economic expectations for China's reopening? And what do you see on the horizon with respect to growing geopolitical tension between US and China?

Jeff: Well, just taking the first question first, I think, again, the underlying, I think people have been overestimating China's potential contribution to the global economy. Again, going back to the 19th Party Congress, the way China looks at its economy is very different now than it had been. And so I think that what the oil market in particular is telling us because you're right, Erik, China reopening should be a huge contribution to global demand for energy. Yet we don't see it in the curves here. The curves are still looking at as if we need more oil going into storage when if China's reopening is going to be a robust reopening, it should sap supplies and production and inventory even more than it already has. Yet the markets don't seem to be concerned about that at all, which indicates that the markets are more concerned about at least near-term and intermediate-term demand and money considerations, which again, I think is consistent with the overall story we'll see in all of these curves. That it can't be a soft landing; it has to be more concerning than that. It has to be more of a contraction that's probably not going to be short, even if it's sharp.
Otherwise, again, I agree that we would see that in the oil futures curve, because China is the biggest importer, the biggest consumer, and for much of last year, good chunks of last year, they had for non-economic reasons closed down a huge part of the country. But as far as the long-run geopolitics of it, I think that's just part of the deglobalization trend. I'm certainly not going to speak for American government and officials and military or otherwise, because it would be crazy to do that. But it's just historically speaking, we have these periods of globalization and then deglobalization, which are closely tied to monetary conditions. This is what happens when you have deglobalization: countries no longer really feel like they need to cooperate, overlook minor issues like they might have in other periods, and instead hype up every little friction as if it's the biggest thing. Because globalization is really about fragmentation, where countries and political regimes start to look closer to home and only care more about taking care of their own rather than getting along with everybody else. And I think that's as true here in the US or in Europe as it is in other parts around the world. It's simply the overriding deglobalization trend, which is reaching uncomfortable levels to say the least.

**Erik:** Jeff, I want to ask you a question about that WTI Futures Curve on slide 31, and how you're interpreting that slight contango at the front of the curve. Because on one hand, you could make the argument, at least as of today, on Tuesday afternoon as we're recording this, that the third-month, that is May-June spread, has moved back out of contango into a very slight backwardation. The first three months were in contango; now it's just the first two months. But the point is, okay, a reasonable person could argue, look, guys, here, you know, you're only looking at the first two months in a fairly modest contango. It's not that big of a deal. What are you making such a big deal out of contango at the front of the WTI curve? We have, you know, contango at the front of the WTI curve. Historically, it's been there a lot of the time, and I don't interpret it that way at all. I see this contango right now as a really big deal. And the reason I say that is because of absolute inventory levels. Right now, in other words, as you said, what puts you into a contango situation at the front of the curve is the market incentivizing storage of oil. Well, storage of oil has to have a cost, which is based on supply and demand.

So when the tanks in Cushing, Oklahoma, are at 90% full, and you've barely got any space left, you've got to have really big contango in order to incentivize storing any more oil. What we have now is generational lows in inventory levels, all the tanks all around the entire country are mostly empty. They've got lots and lots of space in them. So storage shouldn't cost much of anything. And we still have the first three months in contango. In that situation, to me, it's equivalent to a much steeper contango if we had normal inventory levels. Now, I'm inventing this rationale in my head. That's what makes sense to me. But I mean, I can't look that up in a book and say, you know, here's where that's how it's supposed to work. What do you think? Is that the right way to interpret this?

**Jeff:** Oh, you're not inventing this at all. I think that's the only way to interpret this right because there should not be any contango whatsoever.

**Erik:** The level of these inventory levels for there to be any contango is crazy.
Jeff: It's absolutely insane. The curve should be steeply in backwardation. So, the fact that it's even a couple of pennies in contango at the front of the curve already grabbed your attention, because it shouldn't happen at all. There shouldn't be anywhere near contango on the WTI curve. And the fact that it is not only that it's there, but that it persists, it has persisted. And again, I didn't put it on the chart, and it probably should have. If you go back to slide 32, you'll see that steep drop off in the shape of the curve. Guess what that is? That's the October CV. It's all consistent with what we're seeing across all of these markets. The markets are interpreting the slowdown in consumer prices as demand problems ahead. And yet, I agree with you, Erik 100%. There should be absolutely zero contango on the curve. And the fact that it's just a couple pennies, or less than $1 at some of these spreads, and yet the contango moves from the May to June contract in and out depending on any given day. And I think what will really bother me, or what really grabbed my attention moving forward, what will be a warning flag is if the contango does start to spread beyond the near term, or deepen up at the front end of the curve. But yeah, the fact that it's negative at all, that there's any contango at all is a huge, huge warning flag, especially with China reopening. China reopening is supposed to boost demand. I mean, we're at record low inventories, those should be gone to begin with, because China's reopening, and the global system needs to adjust for more oil heading to China. And for some reason, the WTI curve doesn't seem to care one bit.

Erik: Well, Jeff, I couldn't agree more on the interpretation of the WTI curve. That does leave us out of time. I can't thank you enough for a terrific interview. Before I let you go though, I want to go a little deeper on what's going on at Eurodollar University because in our previous interviews, you were working with another asset management firm, but you have decided to essentially focus entirely on Eurodollar University, your study of the global Eurodollar market, which has been fabulously popular with our listeners. For anyone who's not familiar, you can go to macrovoices.com/edu for the original Eurodollar University, which I think was really just the first incarnation of something that kicked off a much bigger activity in your life, Jeff, and for the education of our listeners. So let's start with the end of the first incarnation. Give us the rundown. What's happened? How have you basically grown this Eurodollar University idea? And particularly, I know for people who are fascinated with this, you now offer much more in terms of subscription services and so forth. What is available at Eurodollar.University?

Jeff: Yeah, you're right, Erik, this actually grew out of our original premise, which you told me way back when that we needed to work on this because it wasn't in as good of a deep fundamental format that it needed to be. And that was always kind of in the back of my mind to focus on the Eurodollar monetary story, because it seems to be missing and nobody else really wants to do it. So it's missing from mainstream discourse. I've been fortunate over the last year or so to launch Eurodollar University. As you pointed out, we have subscription services and membership videos where you can subscribe to get various things. I do a daily briefing where I talk about the macroeconomic and market developments through the lens of the Eurodollar system curves. I do a deep dive analysis every day, where we go into a particular topic and take it apart. We also have Eurodollar University memberships that include exclusive videos and content that cover what money is, what your dollars are, what these curves mean, and the basic
fundamentals of money and finance from a macro perspective. Of course, I also do the regular YouTube show, Eurodollar University, which you can find on YouTube. But all the information is available on our website, Eurodollar University. It's my way of picking up where you and I left off and making this more intuitive and a more instructional type of service.

**Erik:** And just for the benefit of any newcomers who don't know what we're talking about. The Eurodollar system is the global lending system, which allows U.S. dollars to be created or loaned into existence by international banks and the premise. Tell me if I'm getting this wrong, Jeff. The premise of Jeff's basic hypothesis is most people think the Federal Reserve is in charge of how many U.S. Dollars are in circulation in the world. That's not really true. It's actually the global banking system that loans more or less US dollars into circulation than the Federal Reserve actually controls and it's an absolutely fascinating alternate look at how the global monetary system really works and what drives it. I have the gist of it, right?

**Jeff:** That's the basic stuff of it. And it really does blow your mind when you start looking into all of the details. All the plumbing issues, how these things work together. And I think once you start doing that, it explains the world and the historical developments so much better than what we've been told.

**Erik:** Patrick Ceresna, Nick Galarnyk, and I will be back as MacroVoices continues right here at macrovoices.com