Briefing: Monday 31, **January** 2022

Domestic Quick Items of Interest

- **Oil Volatility Increasing Risk.** Left to its own devices, US growth looks to be strong. The US consumer is still spending despite inflationary headwinds and corporations are still hiring and investing. There is a lot of risk building if oil markets succumb to geopolitical pressure. The UAE experienced another missile attack overnight as the Israeli Ambassador flew in for a global conference. An anti-missile battery system knocked it down but being the third largest oil producer in the Persian Gulf Region, it riled markets. Brent North Sea Crude was trading at 7-year highs mid-day on Monday.

  The US has also started to get domestic producers ready to increase exports of energy resources if the Ukraine situation increases. The US would have to step up to feed Europe with key energy resources; as we reported last week, Russia supplies about 12% of the world's crude oil. That would also boost domestic prices if the US were asked to fill global gaps in production – especially when active oil wells are still well below levels that we saw in 2019. Rail capacity is still lacking, and major pipeline projects have been halted. The US is not the resource that it was prior to the pandemic. One theory holds that China could consume Russia's oil and would simply reduce resources that it purchases from elsewhere. So, global supply might not change that much, the distribution systems moving it around might be the bigger issue. - KP

- **Dallas Fed Manufacturing Index Dips.** Although it continues to show growth, the Dallas Manufacturing PMI came in at 2 points, down 5.8 points from the month prior (in this reading anything over zero is considered to be a growing sector). Production came in at an eight-month low. Texas is the largest US exporter of manufactured products to other US and global locations and accounts for nearly 10% of total US manufacturing output, although much of it is petroleum and petroleum products. COVID and supply chain product availability was still affecting output in January, and some seasonality was a factor. - KP

- **Busy Week for Data.** Kicking off a busy week for a wide variety of economic data, the week has started oddly with mixed global reports. As you will see in today's report, a wide range of inflation and manufacturing reports suggest that some areas of the world are seeing some unexpected slowdowns and cost cutting in areas like China have started. That runs contrary to much of the news that we get out of other markets.

  But this week will see the US labor situation report, manufacturing and services sector reports, construction, and a wide variety of commodity price reports. We will be watching oil inventory reports closely, the price for global oil has inched above $91 a barrel for the first time since 2014 and that pressure could continue to build if inventories show as being lower. That would also intensify if the US were asked to send more crude oil to Europe in the event of disruptions in Russian crude oil shipments to the region. - KP

Important Domestic Economic Releases

1.31	Start of China's Lunar New Year
1.31	Chicago PMI
1.31	Dallas PMI
2.1	National Manufacturing PMI Releases
2.1	JOLTS report
2.1	US Construction Spending
2.1	Weekly Crude Oil Inventories
2.2	ADP Private Jobs Report
2.3	Services PMI's
2.4	US Full Labor Report for January

Global Quick Items of Interest

- Shooting the Messenger – Turkey is facing a massive inflation crisis – a rate of 36%. This is the highest rate in 19 years and veering close to some form of hyperinflation. This would usually trigger the nation’s central bank to start hiking rates as a means by which to tame this kind of surge but in the world that Reccip Tayyip Erdogan inhabits, that is not an option. **The President of Turkey has long been adamantly opposed to hiking rates – no matter how high inflation gets. He has sacked many central bank heads over the years if they even suggest such a course of action**. He opposes anything that makes borrowing more expensive and would interfere with his many development schemes. His latest sacking is of the head of the statistics office. Apparently even pointing out that there is rampant inflation is forbidden. We suspect that the average Turkish citizen has already figured that out for themselves. – CK

- China Warns US as Regards Taiwan – For decades there has been a very delicate dance played out between the US and China over Taiwan. Beijing has never wavered in its assertion that Taiwan is a renegade province that will someday be brought into the fold and the US has never wavered in its assertions it will defend Taiwan in some way. **Both sides have kept these assertions deliberately vague in order to avoid triggering some real confrontation. China has now abandoned that approach as they have issued a direct statement regarding potential war**. The Chinese Ambassador to the US stated in an interview that Taiwan’s independence efforts would lead to a direct military clash between the US and China. This is the first time the Chinese have declared their willingness to go to war with the US. - CK

- Argentina Cuts Deal with IMF – Argentina seems to always be in financial peril and in desperate need of a bail out. This last year has been no exception. The country had been digging out of the hole it was in from 2018 when the pandemic added more woes. The inflation rate has been over 50% a year and the country owed the IMF billions from the 2018 bailout. **The restructuring of that $45 billion debt is taking some of the immediate pressure off the government but there is no long-term solution in sight**. The sticking point is the same as always exists with IMF loans – a demand that governments become more fiscally responsible. The IMF wanted the Argentine government to cut spending to match revenue, but the Peronists stay in power by essentially buying off their voters with a myriad of giveaways and subsidies that the country can’t afford. This new deal included some of these cuts but not enough to really change the trajectory of the economy. - CK

Additional Global Items we are watching.

- IT Risk from Ukraine? There is a hidden risk from a possible conflict in Ukraine, and it is one that could reach around the world. One of the first actions that a Russian incursion would take is to cut off communications capabilities, take down internet and communication capabilities temporarily and isolate the country.

  Israel published a study this week and found that there could be as many as 150,000 outsourced IT workers located in Ukraine. Many of them are located in some of the regions at highest risk on the Eastern border with Russia.

  There are no estimates that have been released by the US Government on the number of US outsourced IT workers currently living in Ukraine.

  Discussions with employees in Ukraine show that about 80% of them expect to relocate temporarily to the largest cities where defense capabilities are the strongest.

  About 20% expect to make their way to Poland if an invasion were to start. And, depending on how talks at the UN and heads of state talks later this week and next in Russia between Vladimir Putin and the West could dictate whether people start fleeing, and disruptions to IT outsourced services start as they relocate to safer areas. - KP

- Socialists in Portugal Win Majority – The election in Portugal was an exercise in bad political planning on the part of both the left and right. **The ruling Socialist Party was thought to be in trouble just a few weeks ago as their left-wing coalition allies forced a snap election by refusing to accept the proposed budget**. They hoped the voters would side with their demands for more government largesse and strengthen their position. Instead the voters crushed the two far-left parties and reduced their participation in parliament even further – blaming them for the snap election. The center right lost ground to the far right but even a right-wing coalition would not have been enough to unseat the sitting government and now the Socialists have a commanding position which allows them to govern without coalition partners. The economic challenges facing Portugal remain immense but at least now there is a stable government able to negotiate with the EU. - CK

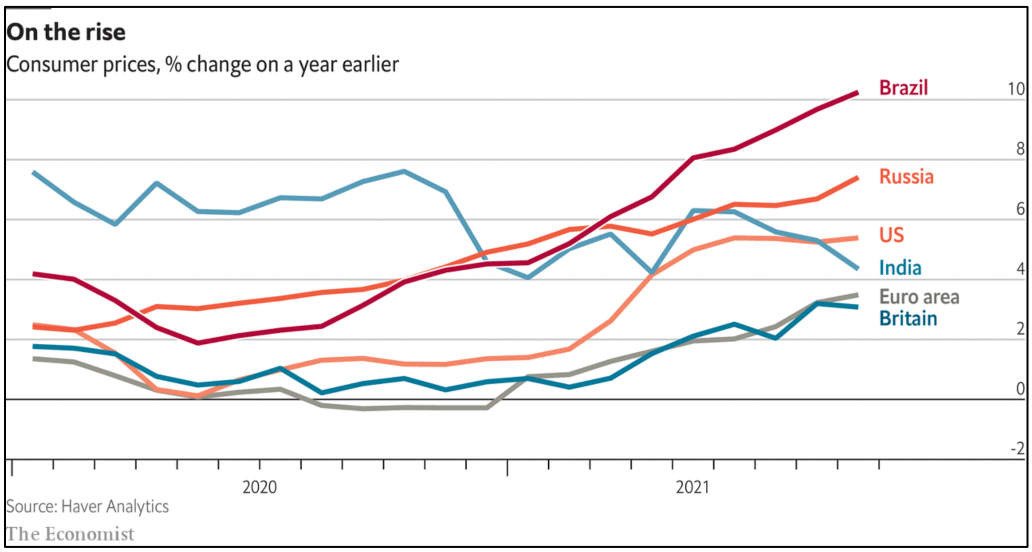
US Domestic Economic Items

- **Where is Inflation Really Heading?** As one would expect, there is a wide diversity of opinion as far as this question goes. **In the most basic of terms there are two schools of thought as regards inflation globally in the next year or two**. One asserts that most of the inflation push has come from the breakdown in the supply chain, reticence on the part of producers and the overhang of cash that was pushed into the economy through the stimulus efforts undertaken by almost every government in the world.

  This group asserts that inflation is transitory and will begin to fade by second or third quarter.

  The other position holds that inflation is being driven by more permanent factors such as higher wages, production shifts and more fundamental government policies that have added to the costs of labor, commodities, and trade. This group sees inflation getting worse and more chronic – reminiscent of the 1970s.

  The view of forecasters has worsened steadily and predictions for higher inflation are more common than they were even a month ago. The chart at right comes from Haver Analytics and The Economist. The rise in the US is expected to flatten out a little but remain higher than it has been in some years. The rise in inflation is expected to continue in Europe and the UK as well as many developing nations.



  There are three reasons the optimists assert that inflation is transitory and three reasons the pessimists believe it is not going to be so short-lived. At this point it is almost a toss-up as far as which outlook will ultimately prove accurate.

  Reason number one for optimism is that much of the inflation surge can be attributed to the supply chain breakdown. The demand that surged forward in 2021 was more than could be handled after the shock of 2020. The producers were caught off guard and so were the transportation providers. There are signs that these players are catching up – albeit slowly. One example has been the cost of a container. These soared from around $3,000 to as high as $23,000 at the height of the breakdown but have now fallen back to around $12,000. This is obviously still far higher than they once were but at least it is headed in the right direction.

  Unfortunately, the load to truck ratio is still worsening as are other transport indicators. It is worth noting that businesses have created more problems for the supply chain by reacting predictably. The boom in Q4 GDP growth numbers (6.9% growth) was fueled almost entirely by inventory build as companies ceased trusting the supply chain and started hoarding. Presumably that hoarding fades and the supply chain gets a chance to correct.

  The second reason for optimism is the evaporation of the money supply. In an effort to blunt the impact of the 2020 shutdown over the pandemic, the governments of the world engaged in massive stimulus efforts. This resulted in a nearly $7 trillion overhang in savings as the consumer was not able to spend most of that largesse. It is standard procedure to throw money at consumers in a recession so they can spend the economy out of that downturn but when the service sector was closed the consumer had far less opportunity to spend and that money just accumulated. The majority of that overhang was spent by the end of 2021 and is no longer affecting inflation as it had been. When people have money, they tend to ignore inflation to a degree and now that this cash has evaporated, the consumer sensitivity increases and there is more resistance to inflated pricing.

The third point of optimism is rooted in competitive behavior. At the moment the business community is passing on every price hike they can. Production costs, transportation costs, labor costs – everything. There is a surge in revenues underway – if not profits. This will trigger some companies to start seeking market share advantage by cutting prices. If the cuts succeed in gaining customers there will be further reductions by the companies that are losing market share. This is not a rapid process however and could be many months or even years in developing.

At some point, market share battles will ensue, and prices would be driven down by competition. That can be a slow process.

Now for the pessimist. What factors lead them to think inflation will worsen?

The short answer is that the factors that have driven inflation to 7.0% in the last few weeks will continue to be a problem. It starts with wages and salaries. There has rarely been a time when workers have had this much leverage and they are using it. Wages have risen by over 4.0% across the board and in many sectors this hike has been even more dramatic (health care, skilled trades and anything connected to IT and high tech). The combination of retiring Boomers, inadequate training, limited immigration, and the pandemic impact on working women has driven labor shortages and these shortages beget higher pay. As wages rise, the employers have few choices other than to hike prices to cover the additional labor cost. This is the dreaded wage/price spiral and it is hard to stop once it begins.

A second potential problem is the continued hike in commodity costs. There are still massive issues with the supply chain that affect every aspect of production. The optimists think these issues will fade but the pessimists are not convinced and think they are more likely to worsen and point to the 6.9% Q4 2021 growth as evidence. The already stretched supply chain has been made worse by the frantic hoarding that drove inventory accumulation towards the end of the year. Other producers remain unconvinced that current demand will hold and are waiting to see what the consumer actually does.

The third issue as far as the pessimists are concerned revolves around money supply. Granted, that $7 trillion overhang has faded as people spent a great deal of that stimulus cash but there is still a massive amount of government aid still trickling into the economy through local governments and businesses. Then there is fact that a booming market has equipped millions with cash reserves. It is going to take a lot to drain this money from the system and the Fed will be inhibited to a degree.

If they hike rates too far and too fast, they risk damaging those that are still trying to recover from the 2020 recession as well as those hurt by the inflation surge. If they move too slowly the inflation threat will not be tamed. - CK

Global Economic Items

- **Eurozone Seems to have Weathered Covid Outbreak** - The fourth quarter numbers in the Eurozone have not been as spectacular as they were in the US, but they came in far better than expected – except in

Germany and that is a problem. Overall, the Eurozone economy grew by 0.3% and even though this was down from the 2.2% notched in the third quarter it was better than had been expected given the impact of the omicron outbreak.

The growth leaders for Europe came as a bit of a surprise – France, Spain and Italy. Germany is 1.5% behind the growth rates sported prior to the pandemic as compared to the US which is now 3.1% ahead of where it was in 2020 and France which is 0.9% ahead of that pace. The Germans have been much harder hit by the energy crisis than others in Europe as they are far more dependent on Russian gas than any other state. Over half of German power demands are met with Russian gas while the rest of Europe is about 40% dependent.

This situation has been years in the making as Germany deliberately phased out much of its coal fired power as well as nuclear. The assumption was that Russia would always need to sell its gas to Europe and that it would always be cheap. The alternative energy efforts were primarily directed towards wind power and that was expected to help reduce the need for these gas imports. These assumptions have all proven to be incorrect and in a major way.

Russia has been busily constructing gas pipelines to China and found a willing buyer able to replace the European market. Add in the tendency for Russia to place geopolitics ahead of economics and you have gas blackmail. The price of gas in Europe has been driven up by over 600% and that has rippled through the global energy market. The wind power expected did not arrive this year as Germany is getting less than 20% of what had been anticipated because of doldrums across wind farm regions. Meanwhile the French are not bothered by the Russian gas play as they remain dependent on nuclear power for over 70% of their power. The "green" initiative in Germany has left them extremely vulnerable to a very unreliable supplier.

Despite the issues in Germany there has been better than expected economic growth in Europe as a whole and that is surprising given the reaction to the pandemic over the last several months. The arrival of the omicron variant caused many countries to reassert the controls that had been slowing economic growth but this time the consumer has not retreated to the same degree as in the past. There has been another collapse in the service sector but to some degree the consumer has compensated with the purchasing of more goods.

There have been significant differences between nations according to the level of vaccination. Italy's growth has been partially attributed to the very aggressive policy towards vaccines while the slowdown in the eastern European region has been blamed on higher infection rates and lower rates of vaccination. – CK

- **China's PMI Shows Manufacturing Slips into Contraction**. It should come as no surprise that the Chinese PMI has slipped into contraction in January amid COVID lockdowns and supply chain disruptions, preparing for the Olympics, etc. The PMI slipped from 50.9 in December to 49.1. But there are some pieces in the report that are worth noting.

  First, Chinese manufacturers noted a slowdown in global demand for their products. Domestic Chinese demand was strong enough to boost overall new orders to a slight increase month-over-month, but demand for Chinese exports fell.

  Chinese companies engaged in cost-cutting and reductions in headcount to contain costs in January.

  Second, something is wrong within China. Chinese manufacturers noted that employment in the manufacturing sector fell in January, but not for reasons that you might think. We like to blame COVID and retirements for the drop in employment in many sectors in the US, but that wasn't the case in China. Chinese manufacturers saw drops in employment as a "result of company down-sizing and cost-cutting efforts". Certainly, some skilled positions were still difficult to fill – but the trend of cost-cutting and down-sizing to reduce overall costs is an alarming statement given just how much global demand is supposedly still in place. **This would be a canary in the coal mine moment, something is awry in China**.

Backlogs of work have fallen for the first time in more than 11 months and the rate of these drops in backlogs were the quickest since July of 2013.

When we focus on the analysis of the data, we learn that there is something broader at work than just the Lunar New Year approaching and Olympics interruptions ongoing through the country. The Olympics alone have forced many workers to spend countless hours in COVID testing lines as a result of the country's zero-case policy.

But the problems are more international. It looks like orders from Europe, the Americas, and other parts of Southeast Asia are slowing according to Chinese Manufacturers. Some of that is due to seasonality, but some of it is a real slowdown in orders of products – from China.

That was not the same as the experiences seen in Vietnam and Taiwan, both of which noted that new order demand from the US and Europe was unusually strong in January. Has a global sourcing shift really begun? The Markit data might suggest that at least for the commodities being ordered across those three countries (China, Taiwan, Vietnam) that there is a difference in order volume trends with China being the one seeing the downturn.

Data shows that China is seeing external orders slowing, but Vietnam and Taiwan are seeing orders expand from the US and Europe.

The US economy was still showing some strength through December, but the Markit PMI survey data is the most recent data that we have available, and **it is reflecting at least a temporary slowdown in global demand. This bears watching**. - KP

Raw Material Items

- **More Articles on Food Challenges Surface – Need Action!** We may be getting to a period of time in which we all need to drop a note to our Congressional members in our states asking for help in the farming sector. Since we ran an article several weeks ago about food fertilizer costs, we are now starting to see national articles to the same effect. The problem is that the window is closing to do something about it.

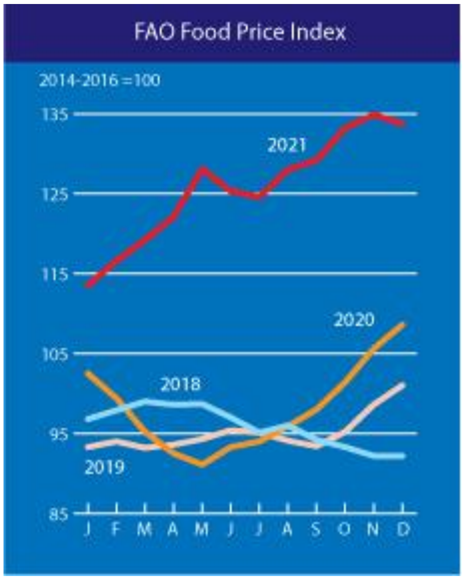
  If you remember, we were speaking with local dealers in the Midwest that were working with farmers about their 2022 growing plans. **One specific farmer said that his normal input costs are roughly $80k a year. This year, he had already had quotes on products showing his input costs would exceed $200K this year**. He would have to get a lot of help from a local bank to increase his borrowing limits – and take a tremendous risk in the event that there is a bad harvest, the market falls, etc.

  Fertilizer costs, according to the Producer Price Index are 98% higher than they were a year ago. Stories coming out now from individual farmers suggest that many are going to opt for planting fewer corn acres because they simply can't afford the fertilizer to produce a good crop. They will likely opt for soybean crops if they can find the seeds! Soybean seeds are reportedly facing shortages. It creates a real conundrum, and the global economy could miss and entire growing season for corn (which is one of the most important grain commodities). It could affect corn prices this year and push them higher well into the end of 2023 until an improved harvest can be experienced.

Even global producers are warning that higher global fertilizer prices are going to be an issue.

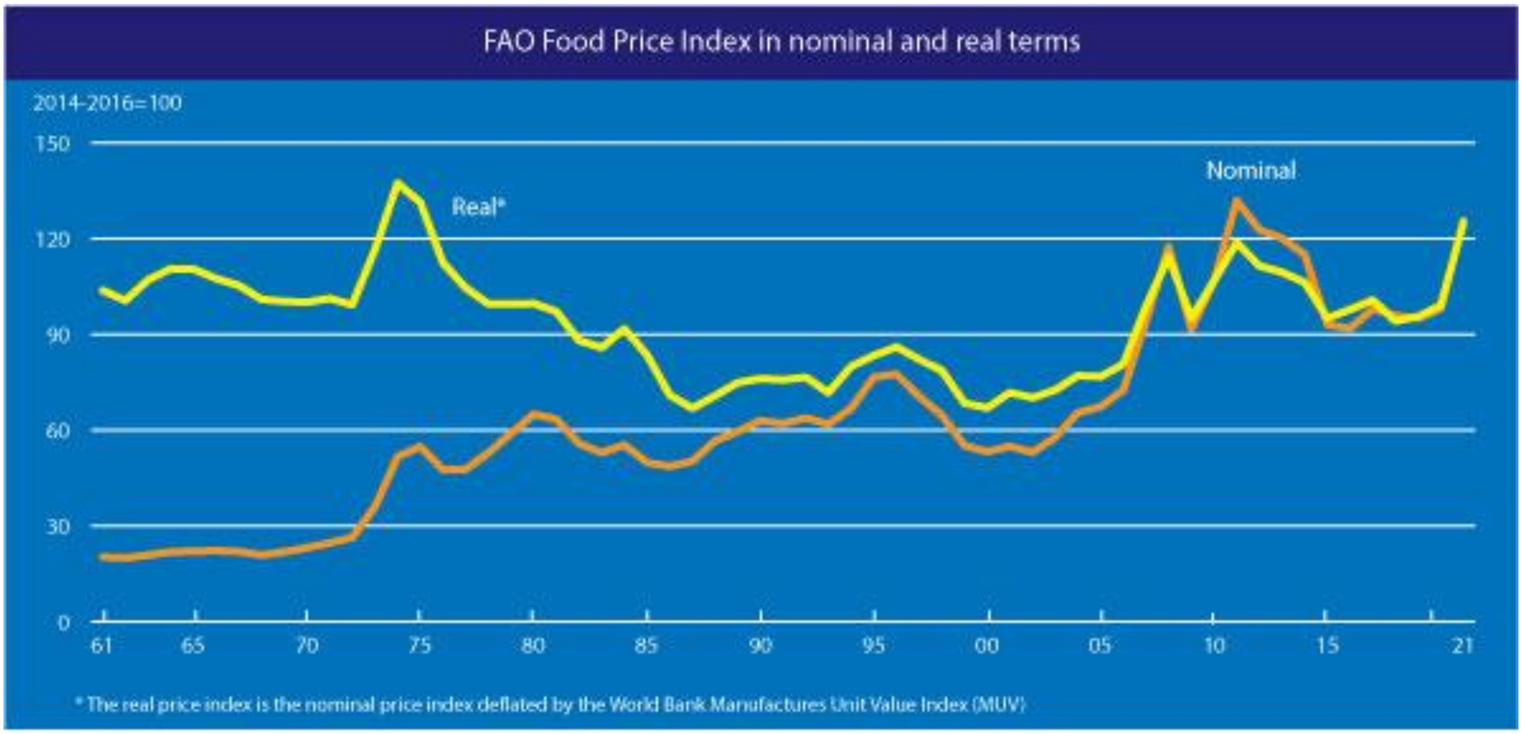
Farmers aren't looking for handouts, at least not according to the ones that we have talked to. They know that the market price of grains will remain high and although they would have higher production costs, they believe they can get a fair price for most grains if they had the cash to bankroll the up-front purchase costs of those products.

How can we not be focused on one of the most critical aspects of our existence? Why isn't it headline news? Food security is critical. Perhaps it is worth it for **the global economy** if there were a subsidy to help offset higher food production costs – especially if they were aimed at bringing down fertilizer costs for just a season.



Remember that **global food prices are currently sitting at highs not seen since 1975 (see the charts)**. As Chris wrote about earlier in today's brief, some countries are starting to experience hyper-inflation and food insecurity can bring out tremendous geopolitical risk and regional conflict. This is worth getting the Federal Government more involved with a financial backstop so that we have food to purchase at prices that the average US consumer (let along global consumers) can afford. **But they have to act fast before planting season is over**.

Imagine where food prices could go from here (already 10%+ inflation in many food segments) if we have food shortages that surface later in 2022 because we didn't get enough planted this spring. - KP



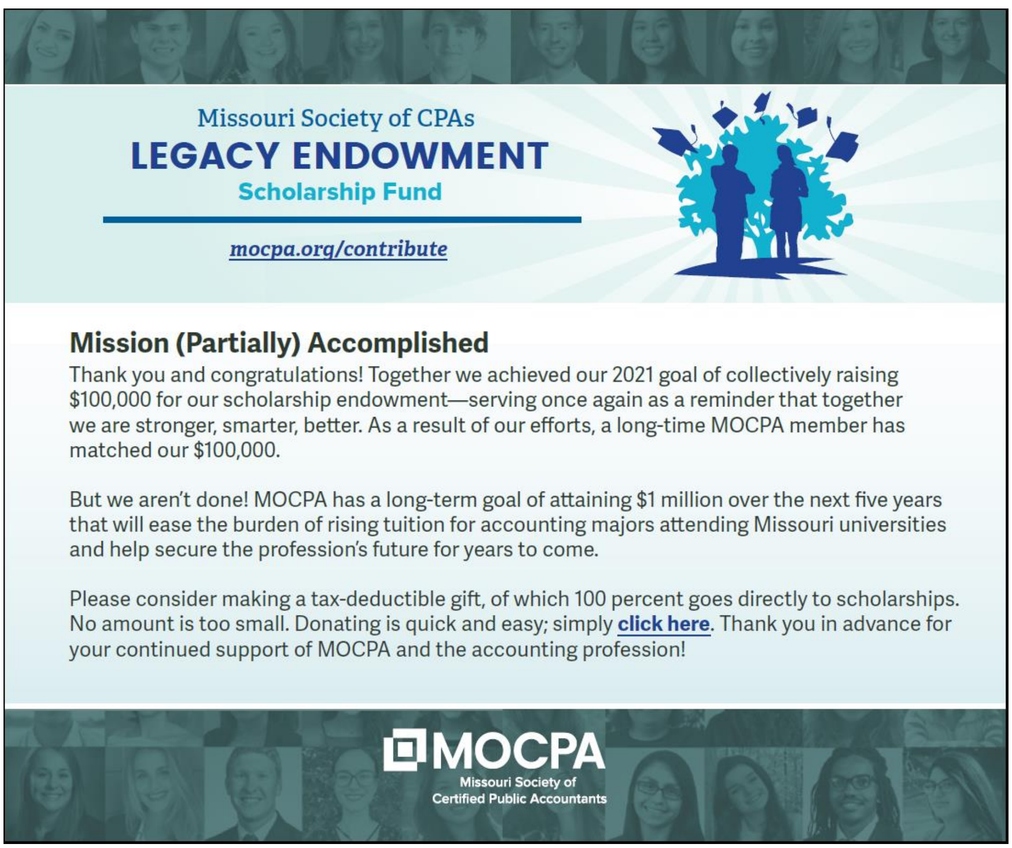
Consider This: Personal Thoughts and Insights from Chris and Keith

- **Meeting the Watermelon Queen** - There are any number of perks available when one travels a lot for a living. I have not been required to purchase shampoo for years as I just keep those little bottles. I have also been able to keep my wife well supplied with shower caps.

  In truth the best perk is the ability to meet so many new and interesting people from a wide variety of backgrounds. I speak to bankers in Boise one day and watermelon growers in Georgia the next. Some of these engagements are more unique than others.

  The Georgia Watermelon Association has a Watermelon Queen – a charming young lady that helps promote and market this crop around the country. Queens seem to be both a southern and agricultural thing and I was impressed by the young women seeking to wear that sash. One minute they are giving a speech extolling the virtues of the watermelon and the next minute they are called upon to compete in the watermelon seed-spitting contest. Through it all they smile and engage.

  Their ambitions are impressive as well – seeking to go into everything from law to speech pathology. As much as I appreciated the involvement of these young ladies, I have to confess that not all the groups I speak to would be appropriate for a queen. In March I speak to the Casket and Funeral Supply Association – that would be a queen I would not want to meet. – CK



Business Cycle Indicators We Are Watching

An Early Warning System for Cycle Changes

We use the following indicators as early warning devices; when they move, it typically signals a change in the current business cycle. We will continue to update these on a weekly basis as new data is available and specific, deeper-dive commentary on these factors will be included in the written portion of the briefing as changes occur.

Country	Current Month	Latest Month Manuf. PMI	Prior Month Manuf. PMI	M/M Change	Current Month	Latest Month Services PMI	Prior Month Services PMI	M/M Change
Global PMI	Dec	54.2	54.2	0.0	Dec	54.6	55.6	-1.0
Eurozone PMI	Dec	58.0	58.4	-0.4	Dec	53.1	55.9	-2.8
US	Dec	57.7	58.3	-0.6	Dec	57.6	58.0	-0.4
China	Dec	50.9	49.9	1.0	Dec	53.1	52.1	1.0
Canada	Dec	56.5	57.2	-0.7				
Mexico	Dec	49.4	49.4	0.0				
Japan	Dec	54.3	54.5	-0.2	Dec	52.1	53.0	-0.9
Germany	Dec	57.4	57.4	0.0	Dec	48.7	52.7	-4.0
South Korea	Dec	51.9	50.9	1.0				
UK	Dec	57.9	58.1	-0.2	Dec	53.6	58.5	-4.9
France	Dec	55.6	55.9	-0.3	Dec	57.0	57.4	-0.4
India	Dec	55.5	57.6	-2.1	Dec	55.5	58.1	-2.6
Italy	Dec	62.0	62.8	-0.8	Dec	53.0	55.9	-2.9
Taiwan	Dec	55.5	54.9	0.6				
Brazil	Dec	49.8	49.8	0.0	Dec	53.6	53.6	0.0
Spain	Dec	56.2	57.1	-0.9	Dec	55.8	59.8	-4.0
Russia	Dec	51.6	51.7	-0.1	Dec	49.5	47.1	2.4
Netherlands	Dec	58.7	60.7	-2.0				
Ireland	Dec	58.3	59.9	-1.6	Dec	55.4	59.3	-3.9
Greece	Dec	59.0	58.8	0.2				
Poland	Dec	56.1	54.4	1.7				
ASEAN	Dec	52.7	52.3	0.4				
Vietnam	Dec	52.5	52.2	0.3				
Philippines	Dec	51.8	51.7	0.1				
Australia	Dec	57.7	59.2	-1.5	Dec	55.1	55.7	-0.6
Switzerland	Dec	62.7	62.5	0.2				
Hong Kong	Dec	50.8	52.6	-1.8				
Singapore	Dec	55.1	52.0	3.1				

Forecast

Real GDP	
2018	2.9%
2019	2.3%
2020	-3.5%
2021 (Est)	5.8%
2022 (Est)	3.5%
Private Investment	
2018	5.1%
2019	1.8%
2020	-16.4%
2021 (Est)	10.6%
2022 (Est)	6.0%
Business Investment	
2018	6.4%
2019	2.1%
2020	-12.8%
2021 (Est)	10.7%
2022 (Est)	7.1%
Retail Sales	
2018	4.4%
2019	3.6%
2020	1.0%
2021 (Est)	8.2%
2022 (Est)	2.5%
New Housing Starts	
2018	1.3M
2019	1.3M
2020	.93M
2021 (Est)	1.6M
2022 (Est)	1.7M
Auto Sales (Annual)	
2018	17.3M
2019	16.9M
2020	14.4M
2021 (Est)	12.9M
2022 (Est)	14.5M