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## Description

# “It Is Possible – Even Probable – That The World System Will Shatter”

*By Michael Every of Rabobank*

### “and such small portions”

**Another messy market day** with bond yields down slightly, stocks by more, and oil up a lot. That was on the back of ugly US data, in particular consumer confidence expectations tumbling to 66.4, the lowest in years, and China reducing quarantine times from two to one week, which despite suggestions that Zero Covid will stay for five years(!), is a possible sign of opening up. The irony is that if China does, or stimulates, growth will pick up, commodity prices will go up, and the Fed will have to act more aggressively. The dollar had an up day, perhaps smelling that too.

**The news-flow was of utopian plans that can't be enacted.** Like the Woody Allen joke about the Catskills hotel with terrible food “and such small portions”, is this a good or bad thing?

**The ECB said it will roll out its anti-fragmentation toolkit from Friday**, the same day it stops doing QE. How will it work? Don't know. Will it work? Don't know. What is the true price of assets against a backdrop of the ECB both removing and injecting bond market liquidity? Don't know.

**The G7 was all about Russia.** The major policies announced were: a “pursuit” of discussions about ideas about a price cap on Russian oil imports (so no actual action); a short-term push for LNG from anyone but Russia; the formation of ‘climate clubs’; and a pledge of \$4.5bn to help fight the global food crisis, taking the headline total for that to \$14bn.

**The ‘oil cap’ is simple in theory:** the G7 will refuse to provide insurance to any vessel that carries Russian oil unless the cargo is sold with an agreed price cap. Yet it won't work and will just push oil

prices higher. Russia will never agree. China and India will never agree either. Russia and China may offer their own underwriting services, **which would force the West into physically blocking cargoes and confronting China – as a Russian-oil carrying ship is stopped in the US, says the Wall Street Journal**. Plus, the G7 are already not taking Russian oil: they are taking Russian oil from India and China that is being on-sold.

In this economic war, the G7 continue to tell their opponents that they will invade in exactly six months, and where, and with which forces, and in the interim demand they are allowed to use that country's beaches: **Russia just counterattacks unannounced** (but not unexpectedly). Russian gas flows to the EU will remain low enough for long enough to teach the West a lesson.

**On LNG, the G7 says investment is “appropriate as a temporary response” but** warns against locking in fossil-fuel use because that would make climate goals unachievable. In short, we need lots of investment and supply – which will then be abandoned. This stance upsets both the environmental lobby and potential LNG exporters and investors.

**The G7 also says DM polluters and EM economies should join ‘climate clubs’** to create global markets for green products through carbon pricing or other climate-mitigation strategies. Just what we need during an economic war – market mechanisms! What this likely means is carbon border adjustment tariffs or quotas on imports from ‘non-green’ countries. These are actually protectionist measures that will separate EM like China from the DM like the US, EU, and Japan, something I have flagged for a long time.

**Today sees FT’s Martin Wolf’s promised answer to our global structural dilemmas** in his op-ed ‘In an era of disorder, open trade is at risk’. It is, as feared, ‘42’.

**He admits we are in an epoch of world disorder**, and we can only save the neoliberal trade order with “great difficulty”. Yet his proposed solutions, besides giving small countries a voice on trade –how? By them going on strike?– are:

1. **Sustainability.** Which means 'climate clubs', which means DM vs. China green tariffs. It also needs huge DM capital flows to EM to finance green transitions during a food and energy crisis, and when the global system breaking down involves EM capital flows to DM via trade surpluses.
2. **Security.** Which means diversifying Western supply chains, which China will fight tooth and nail. It also means allowing governments to set up negative national security lists. Isn't this happening, and part of the problem, not the solution?
3. **Blocs.** Don't allow them. Friend-shoring is not to be embraced. Neither is regionalisation, because it might mean North America and Europe are locked out of Asia. In short, 'don't do anything'. Global problem solved!
4. **Standards.** We need them. But not on labour, perhaps, just the environment and digital services. Who gets to set them, to what end? Isn't this part of China's and Russia's gripe?
5. **Domestic policy.** We need to "[educate] *the public on the cost of protection*" and help "*all those adversely affected by economic changes.*" 40+ years into neoliberalism, and 14 years after the Global Financial Crisis, this is the best we can do?! We just saw 'Build Back Better' turn into high inflation, food and energy crises, higher rates, and a looming recession. Somehow bleating "Free trade goood; tariffs baaaad!" and spending public money on those left behind \*without producing any inflation\* will solve our problems. If it doesn't, Wolf warns "*an ill-informed nationalism is bound to sever the bonds of commerce.*"

**Indeed, Wolf is honest at the end: "*It is possible –perhaps even probable– that the world system will shatter.*"** Colour me unsurprised. If this wasn't the pattern of history, many readers would be Romans. However, he still begs for someone, if not the US, to save global free trade. Which country wants to import from everyone else and deindustrialize in the process? This then takes us back to a more realpolitik great power world. (As has been argued here for many years.)

Yet even in that territory, utopian plans are the order of the day. **It appears Türkiye will now let Sweden and Finland join NATO.** However, NATO has announced its armies will be carbon neutral by 2050. Nice: but how about being capable of winning dirty wars first? As National Defence Magazine was saying a year ago, 'Electric Vehicles for the Military Still a Pipedream'. You can't wait 8 hours to recharge a tank in combat in the middle of a muddy field. You can't power long-range electric fighter jets. And I don't think bombs are carbon neutral.

**UK PM Johnson has had to abandon his 'CPI +0.5% until 2028' defense spending pledge** after CPI rose to 9.1%. Welcome to the real world of real economic power and realpolitik. (As Scotland announces an unofficial independence referendum for October 19, 2023, promising even greater economic uncertainty.) Meanwhile, China has 2.1% CPI and is growing its military spending very rapidly. "*Freedom has to be better armed than tyranny,*" said UK Foreign Secretary Truss recently. **Well, freedom needs a new economic plan then, pronto.**

Indeed, we all do. We rightly focus on the Fed and the ifs and buts and maybes of its pivots and divots, as another 75bps for the next meeting is waved as a prospect. But if it's "*perhaps even probable*" that "*the world system shatters*", perhaps markets should start thinking about what it implies for rates and FX? That thinking is currently served up in such small portions.

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