Rabo: I Love It When Biden's "Plan For Fighting Inflation" Comes Together… I Just Don't Know What It Is

Description

USA: The Wall Street Journal is now running an op-ed by one Joseph R. Biden, Jr. titled ' Joe Biden: My Plan for Fighting Inflation'. The sub-headline is, "*I won't meddle with the Fed, but I will tackle high prices while guiding the economy's transition to stable and steady growth."* In short, he will: 1) let the Fed raise rates as needed; 2) reduce costs for families by boosting the productive capacity of the US economy; and 3) lower Federal budget deficits. I love it when a plan comes together. **I am just not sure what the plan is.**

- President Biden will meet Fed Chair Powell today for the first time since November to "discuss the state of the American and global economy." Will the meeting back what Waller said yesterday: several more 50bp rate hikes past "neutral" territory of 2.50%, so 200bp from here?
- On "productive capacity", does this involve on-, near-, or friend-shoring supply chains, industrial policy, a massive step up in US involvement in (maritime) logistics, and/or capital controls? If not, it's not much of a plan for inflation.
- Tighter fiscal policy is going to be very unpopular into the mid-term and presidential elections, and runs counter to current attempts to resuscitate parts of 'Build Back Better'.

In short, it looks to be higher rates or nothing. Yet on all fronts above the bond market is long and wrong pricing for a Fed pivot, and the FX market short and caught if seeing a weaker dollar. The early post-Memorial Day trading seems to concur, with Treasury yields up around 10-11bps and DXY up too. More so as Brent sits at nearly $122 and WTI at $118, thumbing their noses at 'high prices cure high prices' without the Fed having to stop them *and* the commodity barter trade emerging outside the US dollar system.

The EU is claiming its plan came together as it finally bans seaborne Russian oil, with a temporary exemption for pipeline oil, stopping 2/3 of that flow. Will that hit Russia? Unless the EU is going to stop using oil –which is not the case– it means supply-chain reshuffling as (discounted) Russian oil goes off somewhere else, and the pricier oil they had been buying heads to the EU at higher logistical cost. So that could hurt Russia – *and the EU.* Indeed, what is the broader EU inflation plan as Spanish (8.7% y-o-y) and German (7.9% y-o-y) CPI soars, the latter to a 60-year high, despite energy subsidies? Boost productive capacity in a mercantilist net exporter seen trade deficits due to higher import prices? Tighter fiscal policy that inflames populism?

Again, we are back to rates – yet the ECB is making clear Fed 50s are European 25s, and how many hikes could Europe's periphery take at all before things crack? Traditionally, QE would solve all, but that may no longer be the option it once was. **In which case,… [fill in plan here, ECB].**

Yesterday saw a big market call on EM-like downside risks to GBP that echoes one I've been making for some time more broadly: not the truly EM-like behavior of PM Johnson, but that alongside structural, not cyclical, supply-side commodity shocks, and resulting high inflation, if DM use too much fiscal and monetary stimulus (i.e., QE) to compensate —*while running trade deficits*— they can see their currencies collapse like EM. We aren't there yet, but we could be if we magic up trillions "because markets" in the face of a physical shortage of the imported building blocks of a modern economy. That is how most EM operate 24/7. Post-2008, DM thought the rules were different for them. Maybe they no longer are. Ask Japan for details.

The real risk may then be the current market bull case – that in September the Fed throws in the towel and pivots back to rate cuts and more QE. If that happens as supply-chain issues and commodity squeezes linger (on geopolitical purpose: "Russia should cut oil output by 30% to get better price, Lukoil's Fedun says"), we have a true mess.

Yes, the dollar would initially tumble – but almost everyone else would also then slash rates and do QE too (or 6), in which case it would bounce. Even so, commodity barter trade would likely soar along with commodity prices. Maybe bond yields would be lower: yet they, and the FX they are denominated in, wouldn't buy you as much of anything you actually *need*.

This may sound like 'Bretton Woods 3', but such a 'system' implies collapse and chaos. Does that mean it won't happen? No. But it also means the odds are higher that the alterative *has* to – more aggressive US policy action, *across dimensions*, to keep the current Eurodollar system together in some form.

This logically implies rates are going to have to rise until commodities crack. Given demand for them is largely inelastic, that scenario is incredibly ugly. Yes, *on the other side* we get much lower inflation. Just not yet, Mr. Market. Or at least that's the big picture global view. Individual national data, and curves, will try to tell their own stories until they can't.

Meanwhile, many EM are *already* in dire straits. Sri Lanka is in chaos. Even nuclear-armed Pakistan is warning it faces economic collapse if it doesn't get $36bn in FX financing ahead. Do we have a plan for that on the table in the form of Fed Swaps –for US allies– when Biden and Powell meet? Don't hold your breath, EM: **do hold on to your dollars for now; and your food supplies; and your oil, which was already looking at the best run of monthly gains in a decade.**

And what is China's plan? As it partially reopens Shanghai, pushing commodity prices higher, it can claim zero-Covid works.… until it flares up again, as it has everywhere else. Then rinse and repeat, literally, given its manufacturing PMI for May was 49.6 and services 47.8, which was better than expected. Then again, Bloomberg says 'Chinese Banks Overflow With Cash That Nobody Wants to Borrow', which is hardly positive,… **and yet totally expected.**

Geopolitically, China's grand Pacific Island plan was also locked down, with the regional summit yesterday rejecting it after Australian (and US?) lobbying, and that devastating letter from the President of Micronesia. China also just threatened Israel it will downgrade relations with it if the Jerusalem Post doesn't remove a recent interview with Taiwan's foreign minister from its website: talk about 'Face'. Binary geopolitical competition is now off the drawing board and onto the world map. Large firms can no longer ignore this, even if large asset-managers evidently can.

Please put your A-team to work on a plan for this kind of 'not new normal' global backdrop: "I pity the fool" who doesn't.

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