Rabobank: If You Thought People Were Angry In 2016, Just Wait…

Description

By Michael Every of Rabobank

Everything Is Awesome

In the final part of my ‘Every “Everything” series’ of Daily titles, I am obviously being sarcastic. Everything is obviously *not* awesome. My ‘bond yields AND commodities’ matrix was spot on again yesterday: stocks collapsed (S&P -4%, NASDAQ – 4.7%) as US retail giants spoke about the impact of inflation on consumers, and China saw worse sales of mobile phones than had been feared; US 2-year Treasury yields tumbled from an intra-day peak of 2.73% to close at 2.67%, and 10-years from 3.01% to 2.88%, bull flattening the curve; *AND oil and most major commodities tumbled*. Bitcoin ‘only’ came off around 3%, while the US dollar was on the back foot –wrongly– because if you think the US is in trouble, allow me to introduce you to *everyone else*!

All this as the Fed threatened to raise rates “beyond neutral”: and yet if it doesn’t act to follow, commodities and stocks will go back up again, and we rinse and repeat.

I want to make two points today. First, that so many mainstream market forecasters started the year by saying that everything *was* awesome. (My early January 2022 theme was “Unravelling,” and that, “Whatever your forecast is, it’s already wrong.”) Most ignored the obvious threat of war in Ukraine, and even after it started soon shifted back into default mode: “What happens in Donbas, stays in Donbas,” said one voice recently. ‘Ah, but this is the Fed, not Ukraine!’, some might retort. Except that the ***supply-side*** issues exacerbated by the latter are what the former openly says it is now forced to respond to on the ***demand*** side.

Even many of those who correctly predicted an ‘unawesome’ year in 2022 are arguably **not grasping what the “demand destruction” implied in lower bond yields, lower stocks, and lower prices of *inelastic* commodities, really means.**

It surely means a *deep*, not a shallow recession; a surge in unemployment; an asset-price crash in asset-driven economies; and further humiliation of “experts” and the “consensus view” of how things should be done.

Worse, it means being cold this winter, because one cannot afford to heat one's home, and businesses closing because they cannot pass on higher energy costs. Worst of all it means hunger: a report shows one in four Britons are skipping meals due to inflation already. Now fire lots of them too to bring prices down, eh?

You thought people were angry in 2016? You thought they were angry during 'science-based' Covid lockdowns and restrictions? You thought they were angry when *nobody* built *anything* back better anywhere afterwards? Or when they were censored on social media? Or when a major war started and upended things? **Try making everyone –even billionaires!– much poorer all at once too, because *that is what is happening.***

I saw a comment yesterday that **inflation may shut down talk of fiscal stimulus for years, as it will be blamed**. Perhaps in the circle of "experts" who led us here, yes. Yet in that case we sink deeper into neo-Dickensian socio-economic/political instability. **To my mind, it is more likely that we see massive new populism. First of all, towards emergency stimulus that at least echoes what was done in 2020**. The Daily Mail flags 'Ministers prepare plan to help three million of the lowest paid, offer relief on energy bills and announce pledge to ease burden on business': that is from people who think you can eat a meal for 30p. Other countries will be far more generous – or their societies will be far more rancorous.

That's in the rich West – try emerging markets where food and fuel are a far higher share of the day-to-day consumption basket – which sometimes still is *literally* a basket. We are talking malnutrition and starvation to bring the "demand destruction" implied in lower bond yields. You think that will happen quietly? Yes, it will be 'risk off' in a big way, so again supports lower bond yields in core markets, but that does not capture what that actually implies geopolitically.

So, as EM governments wait for the likes of the "very concerned about global hunger" Janet Yellen to come up with a plan that actually addresses these issues, they will have to step in, whether they can afford it or not: hungry people are not known for their patience. That means more commodity export bans. It means more subsidies. Both are inflationary.

Moreover, Bloomberg today has an article floating the idea of the PBOC dropping 'helicopter money' into citizens' bank accounts using the new eRMB. That is the polar opposite of all Chinese supply-side-pretending-to-be-demand-side stimulus to date. **If it happens, everything changes everywhere all at once**. It means higher Chinese growth; but it means higher inflation too; and far higher GLOBAL inflation against a supply-side shock, which would require more of a Fed rates response; and if such local spending also pushes China towards a trade deficit, it also then collapses their currency as the Fed hikes.

Relatedly, my second point is that while one can blame fiscal expenditure for part of the current inflation, there is a far stronger argument to be made for rising populism to be channelled towards mercantilism and industrial policy than 1980's style neoliberalism and belt-tightening.

Where fiscal stimulus went wrong, and we *all* went wrong, was focusing on the DEMAND side when everything is about the *SUPPLY* side.

Let's go back to basics. I don't mean Say's Law and supply creating its own demand, which is not always true, but rather that almost every politician is guided by an economist, who is guided by their training, which focuses on how to keep GDP growing; and that GDP is DEMAND side, which is mostly driven by consumption in the West, and even many emerging markets.

If you work in markets ask yourself honestly, when was the last GDP print you looked at from the SUPPLY side, other than in an emerging market that, annoyingly, 'doesn't have good demand-side data'? Do you even know the detailed breakdown of what the economy you cover actually supplies? How much oil, gas, coal, or green energy compared to local needs? How much food, and of what kinds? How many tonnes of minerals or metals? How many low, medium, and high tech goods? How many services? *How can one cover an economy and not know this in depth?!*

Easy! Because the market is only interested in keeping up consumption, and the answer is always found via rates (usually lower, creating asset bubbles and matching debt we ignore until we can't – and then do it all again), or fiscal policy (which was just shown to work *too* well when it doesn't involve top-income tax cuts), or, rarely, regulatory reforms.

In markets, we don't care about who actually makes things, because energy, food, goods, and services all just arrive by magic from somewhere, like home-cooked meals delivered to a teenager's bedroom door, or a food delivery service to a trading floor busily bidding up the price of the staple commodities we all need to live because they can't make a high enough return from government bond yields. All we have to do is to focus on how to keep people spending,… right?

Wrong! We *all* need to be doing more of what China has been doing – to focus on the SUPPLY SIDE. Which, given their Marxist (for those who have read him, and understand the difference between 'productive' and 'fictitious' capital) and state-capitalist (for those who have read Hamilton) bent, is what they do best, and we do worst.

Guess what? We can do it too when in a pinch – but not before, sadly.

Yesterday, **US President Biden signed an executive order using the 1950's-era Defence Production Act to compel US firms to increase the supply of infant formula**, and allowing the use of Department of Defence planes to ensure delivery as soon as possible. Well done. Really. Now do the same for all of the key components demanded by the US economy. You can use fiscal spending to do it: just not on anything on the demand side.

There is clearly a desperate need for more energy supply – but no more oil to be had, and no more refineries even if there were. Why not use the DPA to build more refineries? Regrettably, even if it happens, it will take years to see results. That will keep the Fed looking at the demand side ahead – and so markets under pressure.

Of course, Biden is trying to push a Green New Deal and so is the EU, which yesterday announced plans for a 'massive' increase in green energy to help end reliance on Russia. Welcome to the supply side of GDP!

However, too late. It is just sinking in in Brussels (and the US) that solar panels –besides being very un-green to make– are made in China; which is where most rare earths are processed; and most of the mineral supply-chains for electric vehicles lead there, with existing supply sewn up.

Today China is talking about maintaining its subsidies for EV production, which were to end this year: so, it maintains economies of scale AND physical supply chains, while Europe and the US are left with PowerPoint presentations and catchy phrases like 'Green Transition' and 'Build Back Better'(?)

As an early American populist proclaimed, "*You shall not press down upon the brow of labour this crown of thorns, you shall not crucify mankind upon a cross of gold*." Which was all about loose vs. tight fiscal and monetary policy, which is always political. Now we see monetary-policy tightening as people go cold and hungry, and a technocratic reference to "demand destruction" via the supply vs. demand cross if fiscal policy does nothing – and yet worse inflation if it does anything.

Someone is going to have to spend a whole lot more, not less, and on a whole lot more supply, not demand –and in a whole new trading network– if they want to ensure that stocks, bond yields, and commodities don't go down together as angry mobs rise up.

Counterintuitively to some, as all this transpires the US dollar alone will remain bid – even if it is merely just the least dirty shirt in the dirty laundry basket.

I now leave most market forecasters to return to their focus on GDP by demand while predicting a weaker US dollar, rapid recoveries in asset prices, no deglobalisation, and of course no angry populism, while they wait for someone to deliver their lunch – after someone else sweated to grow it, process it, package it, and rush to get it to them for very low wages. Isn't it awesome?

by Tyler Durden

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