Rabobank: There Are Whispers Of A Shift To Physical Commodities Being Used As Trade Settlement

Description

By Michael Every of Rabobank

Name That Tune? Scandinavian Black Metal

When I was young there was a TV show called ‘*Name That Tune’,* where panellists would compete to see how few notes they could name a tune in: I was recently told the same idea has been relaunched as an app. Looking at the key notes struck recently, can you ‘name that tune’?

Many were sure it was “transitory inflation”, but **even Jeff Bezos is Tweeting the White House wanted to spend trillions more dollars than they have been able to, in which case inflation would be even higher than it is now.** There is broad agreement that Friday’s dead-cat-bounce in markets in no way captures the real mood music. As such, some now think the tune is “more new normal”, as Fed Chair Powell talks about 50bp hikes in both June and July, while not ruling out a possible recession, suggesting rates will have to come back down again.

Both those hikes and a recession are likely the right notes. However, many tunes start the same, but then diverge sharply. **Are we really going to see rate hikes *and then rate cuts*?** Arguably, the music now playing is more sinister – but as a result, many are trying to *avoid* naming what the tune actually is.

Think of Scandinavian Black Metal as **Finland and Sweden officially announce bids for NATO membership**, overturning decades and centuries of neutrality, respectively; as Ukraine wins the Eurovision Song Contest, showing the tune the EU public is singing, and President Zelenskiy floats hosting it in demolished and occupied Mariupol; and as France and Germany come last, an EU-wide rejection of their continuous bids to harmonize with Russia.

Think similarly as the G7 warns of 43 million people going hungry if Russia won’t stop its blockade of the Black Sea, which it won’t. That seems an undercount given recent surveys in even Western countries talking about 2 in 7 people facing some form of hunger, and a surge in the use of food banks.

Worse, **India just halted exports of wheat**, or will only sell to those in real need, which injects another layer of (geo)politics into commodities trading.

Likewise, oil remains over $100 despite much of China in lockdown, which Shanghai may lift slightly from 16 May. **Imagine how high oil would be with China open**. Diesel is in short supply, and Bloomberg's Javier Blass says at prices the equivalent of $200-250. There are warnings of diesel shortages in the north-east US, which will bring trucking to a halt. Recent conversations with taxi drivers in London and Singapore, which there are evident shortages of, complaining that current fuel prices mean they struggle to make ends meet. Nigerian domestic airlines have threatened to stop flying completely.

We can *all* name the tune that follows. Pro-China Sri Lanka is in chaos over rising food and energy prices. Pro-China Iran is seeing street protests, despite being a major energy producer – and is still no closer to a nuclear deal despite the EU thinking '*Wandel Durch Handel*' will work in the Middle East in the same way it has *not* worked in eastern Europe or the Far East. China itself, besides sealing people into their homes, is restricting outbound international travel, clipping passports of those arriving, and according to one source, blocking overseas calls.

China also saw terrible data: industrial production -2.9% y-o-y vs. consensus of 0.5% and 5.0% in March; in year-to-date (y-t-d) terms, it was up 4.0%, down from 6.5% from last month; retail sales y-o-y were -11.1% vs. -6.6% consensus, and down from -3.5%, and in y-t-d terms were -1.2%, down from 3.3%; fixed investment y-o-y y-t-d was 6.8% vs. 7.0% consensus and down from 9.3%, the last leg standing; and property investment was -2.7% y-o-y y-t-d vs. -1.5% consensus and 0.7% in March, underlining that the investment seen was into infrastructure not housing. Indeed, residential property sales were -32.2% y-o-y y-t-d, and unemployment ticked up from 6.0% to 6.1%. China's response was to cut mortgage rates 20bp for first-home buyers, but there was no rate cut in the MLF interest rate from 2.85% despite 50-50 market expectations of such a move.

In short, it's easy to look at those data and the terrible fall in real incomes around the world and conclude that rate hikes are a mistake that will end in recession – and worse. However, there are several tunes that follow those obvious notes.

We *could* see the familiar 'new normal' music of a rapid rates retreat, as normal until now.

In which case, we would not just get a knee-jerk rally in bonds and stocks, and a weaker US dollar; **we would also get more *commodity-price* inflation, which would imply even more socio-economic and socio-political polarisation and destabilisation**. As a result, the Fed might sing a new tune.

Look at what just happened in crypto. This obvious bubble, led by people who think if you wear black and sunglasses you somehow *become* Neo from the Matrix, and cheer-led by people who don't care provided it tastes like steak, is likely bursting. If/when it does, it will take trillions in 'wealth' with it. And what will that achieve? First, the primacy of the fiat US dollar over 'safe haven' digital money-printing. Second, it will force millions of people who had walked away from burger-flipping due to 'crypto wealth' back into the workforce. Can you see why the Fed would want that to happen? And all it took was fiat Fed Funds at 1%.

Likewise, as commodities surge, have been weaponised, and are talked of as backing a 'new world order', there are also whispers of a shift to *physical commodities being used as trade settlement.* **Cargoes are still priced in US dollars but, allegedly, de facto barter is already taking place to circumvent the global dollar system and any potential Western sanctions.**

Can you see why the Fed needs to act on that urgently too? This is not an existential threat per se but, as with crypto, it limits the Fed's ability to achieve its goals. Just as if everyone can print their own money **what does it matter where Fed Funds sits, if commodities are so expensive they can be bartered as settlement, how can the Fed bring inflation down?** (As Japanese PPI also hits 10% y-o-y today, and the BOJ keep pegging 10-year JGB bond yields at 0.25%.)

The answer/tune might be for the Fed to go well beyond 1%,… and *stay there*: to do unto commodities what they are doing unto crypto.

If so, inflation then falls. Bonds rally. Real incomes rise – for those who still have jobs. Unfortunately, assets get truly smashed – including bonds for quite some time, and most at the short end. Stocks obviously suffer – unless some people help to ramp certain key names, which obviously never happens. Then again, asset-backed 'new world orders' also get smashed. Which is part of the tune people won't name.

Of course, so do net exporters such as China; and although lower commodity prices would make another debt-driven infrastructure stimulus package more affordable for Beijing, lower exports plus more stimulus plus higher Fed Funds would be *very* negative for CNY – which in that kind of scenario becomes another bubble cheer-led by people who think they are Neo and/or who don't care provided it tastes like steak.

On a related note, the IMF just raised the CNY's share of its Special Drawing Rights (SDR) basket. Yet who cares? The WHO might as well have announced the news. In the first quintennial review since CNY –pointlessly– became an official reserve currency in 2016, delayed a year by Covid, its weighting rose from 10.92% to 12.28%. As I argued in 'Why Bretton Woods 3 Won't Work', current FX reserve holdings of CNY are arguably already *higher* than required by day-to-day activity, so this IMF news changes nothing. Indeed, the US dollar's weighting also rose from 41.73% to 43.38%, while the euro's dropped from 30.93% to 29.31%, JPY's fell from 8.33% to 7.59%, and GBP's from 8.09% to 7.44%.

With PM Boris Johnson apparently about to walk away from the Northern Ireland protocol, potentially triggering a UK-EU trade war, GBP was already likely to stay under pressure.

Let's see what there is to 'note' today on that front, and others.

by Tyler Durden

Category

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