Trading Houses Will Collapse As "Margin Call Doom Loop" Goes Global, Trafigura CFO Warns

Description

Sometimes repo guru Zoltan Pozsar is so far ahead of his time, it takes the "experts" weeks just to read up on all the required source docs to even grasp what he is talking about.

Last week we reported that the Bloomberg news that one of the world's largest independent energy merchants – the secretive Trafigura which trades hundreds of billion in commodities every year – was facing **"margin calls in the billions of dollars"** meant that the commodity "***margin call doom loop"*** idea floated more than three weeks ago by Pozsar who warned that commodity traders and clearinghouses could be facing a liquidity crisis of historic proportions, was coming true and despite Barclays' earnest attempts to minimize its impact, **could threaten broader financial stability and was manifesting itself in broad liquidity squeezes which could be observed in the surge in such unsecured funding markets as the FRA-OIS.**

That was just the start, because the very next day Zoltan was proven correct again, after the FT reported that Europe's largest energy traders have taken the place of Europe's insolvent banks in calling on governments and central banks to provide "emergency" assistance to avert a cash crunch as sharp price moves triggered by the Ukraine crisis strain commodity markets.

Yes, that's what happens when a *"margin call doom loop"* goes global.

The FT wrote that in a letter it had seen, the European Federation of Energy Traders, a trade body that counts BP, Shell and commodity traders Vitol and the margin-call stricken Trafigura as members, said the industry needed "time-limited emergency liquidity support to ensure that wholesale gas and power markets continued to function".

"Since the end of February 2022, an already challenging situation has worsened and more [European] energy participants are in [a] position where their ability to source additional liquidity is severely reduced or, in some cases, exhausted," EFET said in its letter, dated March 8 and sent to market participants and regulators.

It was “not infeasible to foresee . . . generally sound and healthy energy companies . . . unable to access cash”, the letter warned, clearly ignoring that “generally sound” companies would have anticipated such a fat tailed scenario. The fact that they didn’t suggests that they were either not “generally sound”, or “healthy” and certainly did not plan accordingly. And yet somehow their stupidity and/or greed makes them eligible for Fed bailouts?

> The 4-page letter from lobby group the European Federation of Energy Traders pleading emergency liquidity support in full (with my own highlights).
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> EFET represents top trading houses, oil companies and utilities (think the likes of Vitol, BP, Trafigura, Uniper, Engie…) #OOTT pic.twitter.com/cVxzlqrJrO
>
> — Javier Blas (@JavierBlas) March 16, 2022

Days came and went, with nothing but silence from the central banks who perhaps ignored the severity of the coming liquidity crisis, and why not – after all most of the world’s biggest commodity traders have more than one billionaire in their org chart, let them spend money to bail out their companies. But while this particular bailout request may have sounded too grotesque to both central banks and the general public, to the commodity firms the sudden margin-call induced liquidity shortage was all too real.

Fast forward to today, when in a follow up to its report from last week, the FT writes that according to Christophe Salmon, Trafigura’s chief financial officer, the crisis in global energy markets will force some smaller commodity traders out of business and unleash a wave of consolidation in the sector.

Salmon warned that the spike in capital needed to keep commodities flowing around the world since Russia invaded Ukraine would squeeze smaller trading houses out of the market.

Christophe Salmon: ‘The barriers to entry to our sector as supply chain managers are increasing’

“When we go through these crises — and let’s not forget we’re getting out of two-and-a-half years of Covid situation — there will be another set of consolidation of the commodity trading sector,” Salmon told the FT Commodities Global Summit in Lausanne on Wednesday.

The global commodity trading sector is dominated by large groups such as Trafigura, Vitol and Gunvor but Salmon said many smaller traders were facing a multitude of problems from rising capital requirements to a lack of access to credit.

“The barriers to entry to our sector as supply chain managers are increasing,” he said.

Salmon’s dire comments come as every day we see confirmation of Pozsar’s worst case scenario, and amid the rising concerns about a liquidity crisis sweeping commodity financing, Europe’s largest traders continue to plea with banks and governments to offer “emergency” assistance to prevent a cash crunch as large swings in commodity prices push up the cost of trading. Of course, since these are independent trading houses which several years ago their paid-for lobbyists were trotted out to explain that they are not – in fact – systematically important, we fail to see how they could possibly make a case where taxpayer funds goes to bail out a handful of billionaires, when simple nationalization would do.

It is this worst case scenario that has prompted nothing short of panic among traders at the FT conference, who have voiced concerns that difficult conditions such as banks demanding hefty initial margins — cash for hedging future contracts — had contributed to a breakdown in the proper functioning of commodity markets, particularly gas and nickel.

Fears over hydrocarbon supplies from Russia, the world’s second-largest gas producer and third-biggest in oil, have rattled markets. Europe has yet to impose sanctions on Russian energy exports but banks, shipping companies, insurers and refiners are “self-sanctioning” and avoiding touching oil from the nation.

In a delightful irony, this is not the first time that commodity trading houses have been this close to collapse: back in 2013/2014 during their last near-death experience when Chinese commodity financing imploded and pushed trading giants such as Glencore close to collapse, the industry promptly trotted out its “paid for hire” mercenary consultant to draft white papers (even more ironically, the White Paper was commissioned by Trafigura) that the sector was not, in fact, ***too big to fail*** (the alternative would have been partial or complete nationalizations). Oh how they wish they could reverse on this optimistic take now.

So just to make sure that the message is heard loud and clear, Salmon said that if the commodity traders go down, they will drag the rest of the world with them, and that “ruptures to commodity financing would feed through to consumers.”

“We are already in a vicious cycle on the futures market. I want to stress the impact that it will have on the physical market,” he said.

“We are more and more engaged with governments in order to inform the governments of the likelihood of market disruptions, meaning stock-outs of certain products in certain regions.”

Translation: watch for 1970s style lines at your local gas station, something that is probably taking place in Europe as we type: European gas prices jumped to more than €300 per megawatt hour this month before easing below €100, while Brent crude, the international oil benchmark, has risen 20 per cent since the invasion of Ukraine to $118 per barrel.

Furthermore, as discussed yesterday when we observed the coming diesel crisis, these same traders expect to have higher levels of working capital tied up with more barrels on the sea since Russian oil must travel further to Asian customers and replacement supplies for Europe must also spend more time in transit.

Salmon’s observation over the viability of smaller traders comes amid uncertainty over the future of Gazprom’s UK trading arm, which Boris Johnson’s government is on standby to put into “special administration”, a de facto nationalization. The unit is vital to the cheap supply of energy for many British industrial businesses.

And while Salon waits for some response from central banks, he isn’t taking any chances and on Wednesday, **Trafigura said it had closed a $2.3 billion revolving credit facility,** adding to a $1.2 billion package arranged earlier this month and after exploring funding from private equity groups. As reported previously, **Trafigura has also been holding talks with private equity groups to secure additional financing,** although for now it appears that those talks haven’t gone anywhere.

Trafigura aside, things among the trading giants are going from bad to worse: earlier today we reported that Mercuria Energy Group, a Swiss commodity trading giant, secured a $2 billion emergency credit facility from banks as commodities prices surge following Russia’s invasion of Ukraine. The credit facility, which was secured earlier this month, can be renewed or closed in six months time, Bloomberg reported, adding that trading houses have been seeking funds to maintain their physical and derivative positions as prices of everything from natural gas to metals soar. With markets upended and sanctions threatening to disrupt raw materials supplies, traders are facing a liquidity squeeze that could reshape the sector.

“We do have to size our activity and our risk appetite with our financing capability. It’s as brutal as that,” Frederic Barnaud, group chief strategy and commercial officer at Mercuria, said Wednesday in a panel discussion at the FT Commodities Global Summit in Lausanne.

Hilariously, the Geneva based Mercuria was facing a mini liquidity crunch not long after it posted a record profit in 2020 as it cashed in on wild swings in gas, power and oil markets during the pandemic. “You cannot be too hungry on profit and risk taking and not have the infrastructure and relationship with banks or other ways of capital forming to endorse your businesses,” said Barnaud.

The report prompted us to point out that between Trafigura, Gunvor, Mercuria, “every commodity trader hit with massive margin calls”, explaining their desire to get some of that sweet, sweet central bank bailout money.

> Mercuria Secures $2 Billion in Emergency Credit From Banks
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> Trafigura, Gunvor, Mercuria – every commodity trader hit with massive margin calls
>
> — zerohedge (@zerohedge) March 23, 2022

There was more turmoil elsewhere in the commodity world today. Qatar, the biggest shareholder of the world's best known commodity trader Glencore sold a stake worth $1.1 billion (the Qatar SWF is selling 159 million shares out of its stake of 1.22 billion shares). After the sale, Qatar will drop to 2nd largest holder in Glencore, and former CEO Ivan Glasenberg will climb to 1st.

> Covered pic.twitter.com/5YbXYfSes3
>
> — Neil Hume (@humenm) March 23, 2022

Another commodity trading giant, Gunvor Group, a leading oil and liquefied natural gas trader, also rushed to shore up its liquidity saying that it may boost its equity by selling a stake, the latest sign of how volatile commodity markets are pushing trading houses to scour for new sources of capital.

Torbjorn Tornqvist, Gunvor's chief executive officer and controlling shareholder, said that the company had reduced its trading volumes as a response to higher and more volatile prices. An equity partner would allow the company to grow, he said.
"For us to go and really, shall I say, exploit the potential of the company, it would be desirable to explore additional equity," Tornqvist said at the Financial Times Commodities Global Summit. "We are open to find an alliance which could increase the size of the company."

As we reported at the time, Gunvor was one of a clutch of large natural-gas traders facing huge margin calls in October, when prices spiked in Europe. The company has adapted its trading to accommodate higher and more volatile prices, it said this week.

"We are doing less volume than we normally do," Tornqvist said on Tuesday. "In the right time, we can size this up in no time. This is our business model."

Tornqvist took a majority stake in Gunvor in 2014, after co-founder Gennady Timchenko was sanctioned by the U.S. over ties to Vladimir Putin following Russia's 2014 annexation of Crimea. Timchenko subsequently exited the company. The trader, based in Cyprus with major trading operations in Geneva, has repeatedly denied any connections to Russia's leadership. In a statement this week, it highlighted that only 6% to 11% of its trading book over the past five years has originated in Russia, and said it was doing no new business in the country.

Tornqvist, who owns 88.4% of Gunvor, has been looking to reduce his stake for a number of years. In 2019, the company held talks about selling a stake to Algeria's state oil and gas producer, Sonatrach. But the talks ended amid political upheaval in Algeria. The rest of the company is owned by other employees. Any potential equity partner would need to complement Gunvor's existing business, and Tornqvist said he doesn't intend to step back.

“I’m not in the market to sell out,” he said, confirming he was in the market to sell out, and if commodity volatility persists at the current pace for a few more months, all of his colleagues at the helm of the handful of giant commodity traders, will be doing the same. The question is whether there will be any buyers.

by Tyler Durden

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