Ukraine Cuts Off Gas to Europe and the Inflation Double Whammy

Description

You read that right. Ukraine announced today that it is cutting off a third of the natural gas flow to Europe:

> Gas Transit Services of Ukraine (OGTSU) declared force majeure on Tuesday, saying that it was impossible to continue the transit of gas through a connection point and compressor station located in the Lugansk area. As OGTSU personnel *"cannot carry out operational and technological control"* over the Sokhranovka connector point and Novopskov compressor station, the company cannot continue to fulfill its contract obligations, it said. Gas from this connection will not be accepted into the transit system of Ukraine starting at 7 am on Wednesday, OGTSU said.

The motive behind this move is irrelevant. The "why" does not matter. It is the negative effect it will have on an already shaky European economy. First, when the supply of an essential good or commodity like gas is reduced significantly the price will increase dramatically. That adds to inflation in Europe. It is akin to a game of musical chairs. But instead of having 10 players competing to snag a seat from 9 chairs, we now have 10 players but only 5 chairs. The competition will be fierce.

Second, the reduced supply will probably force some businesses to close shop. That means some unemployed people. So not only will the affected countries face higher costs, they also will be burdened with more jobless people.

Third, there is a ripple effect. The price surge and the loss of product or services from businesses forced to close their doors will spread outward and produce negative effects in the countries that are trading partners with nations forced to curtail use of natural gas.

If this a ploy by Ukraine to put pressure on Europe in order to secure more support in terms of money and weapons it is a stupid move. It is the proverbial angry dog biting the hand of its feeder. Dogs are smart but they cannot run a can opener. Unopened cans mean no food.

The inflation that is now surging in Europe and the United States (and in other countries for that matter) is doubly dangerous because it is not the traditional inflation. What do I mean? Traditional inflation is a product of printing too much money and that money chases a relatively fixed amount of goods. Here is the Investopedia explanation:

> Inflation can occur when prices rise due to increases in production costs, such as raw materials and wages. A surge in demand for products and services can cause inflation as consumers are willing to pay more for the product.

This current beast is different and more dangerous. First, there are increases in production costs, specifically labor, that is a consequence of the Covid shutdowns. Many employers are having to raise wages in order to entice workers to come back.

Second, there are supply shortages. One of the biggest supply shocks involves computers chips and automobiles:

> According to a study released by the US Department of Commerce, the median inventory of computer chips held by consumers — like automakers and medical device manufacturers — fell from 40 days in 2019 to less than 5 in 2021. The implications of this are dire. "If a COVID outbreak, a natural disaster or political instability disrupts a foreign semiconductor facility for even just a few weeks, it has the potential to shut down a manufacturing facility in the US, putting American workers and their families at risk," the report noted, a danger that isn't lost on car companies.

Three guesses who is the largest producer of this chips? China, China and China. Car lots that were loaded with new vehicles three years ago now stand vacant. I shot the following at a KIA dealership in Sarasota, Florida a couple of months ago. This was at 1030 in the morning on a normal business day:

If you do not have cars on your lot then you cannot sell cars. Remember those pushy car salesmen? They are having to find other work because there is no inventory.

Now for a newsflash (I am burying the lede)–China is using Covid as a convenient excuse to sabotage the U.S. economy and it is helping fuel inflation. The recent lockdown in Shanghai, for example, makes no sense. For the first two years of the pandemic, China reported one of the lowest infection rates in the world and did not embark on massive lockdowns. Now, out of nowhere, China claims to be battling a deadly disease.

One of the major consequences of this effort to quell Covid in China is further disruption of critical exports to the United States. Instead of coming out and declaring it was retaliating economically against the United States, China is using Covid as a convenient excuse to damage the import-dependent U.S. economy.

Making the picture even more complicated is that the United States is demanding stridently that China sign on to draconian sanctions to punish Russia. China ain't playing that game.

Inflation in America is rising like a massive Tsunami wave and will sweep over all of the economy. We are already experiencing shortages of chips and baby formula. Food shortages will continue to appear and multiply and desperate consumers will have to pay more for a limited number of key commodities.

We are not talking about an isolated event. This is the equivalent of a nuclear bomb going off over New York City and Washington, DC. It is a perfect storm–shortages of key commodities, rising fuel prices, massive cuts imposed by sanctions of key minerals only available from Russia, and trillions of U.S. dollars floating around the globe as key international trading partners shift to other currencies.

If you hold a low interest loan, hang on to it for dear life. I fear we are on the verge of an inflationary disaster on a global scale. Ukraine has just added a new log to the fiery pyre that is starting to consume the international financial structure.

By Larry Johnson

Category

1. Economy-Business-Fin/Invest
2. Main

Date Created
May 2022