

Nickel crisis points to fragility of global finance

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The extreme fragility of the global financial system in the wake of the sanctions imposed on Russia by the Western powers has been highlighted by the negotiations involving some of the world's biggest banks to resolve the crisis in the nickel market that erupted last week.

Yesterday it was announced that major banks, including JPMorgan Chase and Standard Chartered, had reached an agreement with the Chinese metals firm Tsingshan Holding Group not to press to close out the company's position in nickel trades or to make further margin calls. Such calls are demands for additional cash from the company that result from its failed bets in the nickel market.

Tsinghsan had shorted nickel in a series of contracts in anticipation that its price would go down. However, in the wake of the war crisis in Ukraine, the price shot up, leaving the company with a potential loss of billions of dollars. The company is the world's biggest stainless steel producer and a big consumer of nickel.

After trading at around \$30,000 per tonne, the price of nickel jumped to \$50,000 on Monday of last week on the London Metal Exchange (LME). It then doubled to \$100,000 the following day, whereupon the exchange closed its nickel market and left it closed until yesterday.

Following the agreement, the LME is expected to reopen today.

The deal between the banks and Tsingshan does not fully resolve the issue as the company is still on the hook for the money it owes. It is a standstill arrangement aimed at working out an agreement for new credit provisions and for the company to settle its "nickel margin and settlement requirements."

In effect, the major banks have decided not to immediately press ahead with their margin calls lest

this spark a wider crisis.

While it plans to reopen, the LME has said it will introduce daily price limits for all metals, including nickel. Members will be asked to disclose all contracts in derivatives markets of more than 100 tonnes.

Announcing the decision, the LME said it had noted that a "large client of the market has now published details relating to the support of a banking consortium, which could suggest that the potential for further disorderly conditions may be mitigated."

The nickel market is relatively small and Tsinghsan's losses, while running into billions of dollars, did not in and of themselves pose a threat. But the wider implications of the incident did.

The *Wall Street Journal* (WSJ) reported that producers and manufacturers of nickel-related products in China have said their operations have been adversely affected. More than half a dozen Chinese companies have sent notices to their customers and investors warning of problems in supplies, price increases or the inability to meet orders.

Jilin Jien Nickel, which manufactures nickel sulfate and nickel chloride in eastern China, issued a letter to customers last week advising them it was likely to lose money because of the increased cost of imported raw materials.

"A ruthless game of capital has come to us with lightning speed," the letter said. "It has brought an unprecedented survival crisis to those responsible and hardworking enterprises' including us." It warned that "huge losses are no longer avoidable."

According to the WSJ, the China Nonferrous Metals Industry Association, whose members include hundreds of firms, both state-backed and privately owned, said last week it was highly concerned about the "irrational surge" in nickel prices on the LME which had caused

serious damage to companies in the global nickel supply chain.

On top of the effects in the real economy, there is the impact on financial markets and the cloud of uncertainty hanging over all commodities trading and the associated complex web of derivatives contracts that can be hit by violent price swings.

A comment in the WSJ headlined “Will Financial Stability Get Nickel-and-Dimed?” posed the question of whether the nickel crisis, which left the world’s biggest producer struggling to find billions of dollars to fund margin calls, was the “canary in the nickel mine” for the whole financial system.

It was common for commodity producers and miners to hedge their prices, the article noted, but when prices swing wildly there could be a mismatch in cash flows and traders must post additional collateral to meet margin calls from their lenders.

Nickel is by no means the only globally traded commodity to experience wild price swings. Coal prices in Asia doubled in February and March before falling back. Aluminium and wheat prices have experienced surges, and the price of oil continues to gyrate. It has risen as high as \$130 in recent days and then fallen to just below \$100.

Traders who make deals can be caught out to the tune of billions of dollars virtually overnight if they are on the wrong side of these rapid movements.

As the WSJ comment noted: “No one knows exactly what lies ahead for commodity prices but the idea that Tsingshan is the only company out there with big hedges that could go very wrong might prove optimistic.”

Credit Suisse strategist Zoltan Poszar has likened the present situation to that which set off the global financial crisis of 2008—the collapse of prices for collateralised debt obligations (CDOs) based on mortgage-backed securities.

In a note written earlier this month, Poszar said: “Russian commodities are like subprime CDOs were in 2008.” The financial markets froze then because investors became unsure how much exposure their counterparties had to toxic subprime-based financial assets. Now the uncertainty is how much exposure financial traders and speculators have to Russian assets and Russian produced commodities.

Financial Times writer Patrick Jenkins has also

pointed to the broader effects of the sanctions on Russia, saying he was “not sure that the potential impact for the world outside Russia has been fully acknowledged.”

The spiralling cost of commodities could “take out financial operators, large and small, mainstream and marginal,” he said, citing the suspension of nickel trading by the LME in a comment piece published earlier this week.

Jenkins likened the present situation to the crisis in 2008, which was set off by the collapse of the investment bank Lehman Brothers. He noted that since then the world has been awash with free money because of central bank policies, resulting in inflated asset prices and debt levels that have risen to new records.

“Be under no illusion: Russians will not be the only ones to suffer under Russian sanctions. The world should remember Lehman and brace for a global financial and economic shock,” he concluded.



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