Commodity markets in turmoil

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The wild movements in the prices of commodities, including oil, wheat and industrial metals, following the imposition of sanctions on Russia, are sending shock waves through the financial mechanisms and markets used to facilitate trade deals.

The initial impact was the closure of the nickel market of the London Metal Exchange for more than a week at the beginning of March after the spot price of the metal doubled in a single day to reach $100,000. The spot price surge left a major Chinese steel company facing potential losses running into billions of dollars because it had made financial deals based on a falling price.

The market closure was described as the "canary in the coal mine" for major commodities markets and that has proven to be the case.

On March 8, the European Federation of Energy Traders (EFET), which includes BP and Shell, as well as major commodity traders Vitol and Transfigura, sent a letter to market participants and regulators calling for emergency assistance.

According to the letter, the contents of which were published last week, the energy industry needed "time-limited emergency liquidity support to ensure that wholesale gas and power markets continued to function."

The problem confronting traders is that they are increasingly unable to finance derivatives contracts they take out to try to hedge their positions on deals. This is because banks and other lenders are raising their margin calls on the loans they have made to finance such contracts, due to the uncertainty surrounding price movements.

"Since the end of February 2022," the EFET letter said, "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."

The letter warned there was a possibility that generally sound and healthy energy companies would be "unable to access cash." The issue is regarded as so serious that it has been discussed with central banks.

The volatility in energy markets is reflected in the fact that prices in the futures markets linked to the European gas market jumped by almost 200 percent earlier this month.

According to a report in the *Financial Times*, the EFET wants central banks, including the Bank of England (BoE) and the European Central Bank (ECB), to provide support to lenders to soften the impact of margin calls.

In an interview last week, EFET executive vice chair Peter Styles said guarantees that exchanges would be the backstop in the event of defaults would allow them to provide greater margins to companies involved in trading.

"The main objective is to ensure that there is still an accessible, orderly market in energy futures, particularly for gas and power producers and suppliers who need to hedge in these difficult times," Styles said.

While the ECB and the BoE have spoken with representatives of energy firms and commodity traders, they have so far not given any commitment.

The extreme financial tightening was indicated in comments by Russell Hardly, the chief executive of Vitol, one of the world's major commodity traders, who told the *Financial Times* (FT) that participation in the spot market had dwindled because of the cost. To move cargo of liquefied natural gas priced at €97, traders had to price €80 in cash, placing a strain on their financial resources.

The money provided to traders in commodities such as oil, gas and wheat, is returned once the commodity is delivered but while the deal is being finalised, the trading firms face liquidity problems.

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The extreme volatility in gas prices is revealed in the futures market. On the eve of the Russian invasion of Ukraine they were about €80 a megawatt hour. They then rose to more than €300 earlier this month and have since fallen back to below €100. Two years ago, they were less than €20.

Gas is not the only problem. Speaking at the FT Commodities Global Summit in Switzerland this week, the heads of three of the world's largest commodity traders—Vitol, Gunvor and Transfigura—warned of a diesel shortage.

Vitol chief Hardy said Europe imported about half of its diesel from Russia and about half from the Middle East. The "systemic shortfall of diesel is there," he stated.

Torbjorn Tornqvist, the chair of Gunvor, said: "Diesel is not just a European problem, this is a global problem."

In addition, the European gas market was no longer functioning properly because of the demands from banks for cash from traders to cover their margin positions. "I think it's broken," he said.

Reporting on what it called the "cash crunch" in commodities markets, the *Wall Street Journal* (WSJ) noted it extended far beyond Russia and Ukraine.

"Trade that is not even linked to Russia or Ukraine is getting more and more difficult to finance," one senior portfolio manager said, and commodity traders, producers and lenders were withdrawing support from what were regarded as "economically fragile" countries such as Egypt and Tunisia.

Egypt is the world's largest importer of wheat with as much as 85 percent of its supplies coming from Russia and Ukraine.

The WSJ article noted that according to traders, "a vicious financial cycle is exacerbating the volatility and could worsen in some parts of the world."

It cited Jack Bardakjian, the founder of the London-based Gapuma Group which ships fertilizers, foodstuffs and petrochemicals into Africa, who said he had approached banks, asking them to double their credit lines, but they were only willing to lend 20 to 25 percent more.

"There are some huge, huge humanitarian issues that could be developing because of this," he said.

One of the reasons for the refusal of banks to lend more is their fear that commodity prices will fall, and they will be faced with losses on their margin loans.

The upshot is that hundreds of millions of people are being confronted with massive cuts in their living standards and extreme hunger in some cases because of the profit demands of the banks and finance houses as well as the operations of speculators who see the violent swings in commodities and the social misery it is producing as a highly lucrative opportunity.

There is only one way to change this situation—the fight for a socialist program and the reorganisation of the world economy based on human need. The impetus for that struggle is coming from the very development of the global financial and economic crisis itself which will drive the working class in all parts of the world into major battles against the operations of the profit system.

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