

Commodity market turbulence heightens financial instability

Nick Beams
15 April 2022

There is growing turbulence in financial and commodity markets as central banks move to lift interest rates under conditions of rapidly rising inflation not seen in the past four decades.

Dealings in global commodity markets for basic items, such as oil and gas, industrial metals, as well as grains and other foodstuffs, have been characterised as “chaotic” as prices spiral and gyrate.

The market volatility, which has been exacerbated by the US-NATO proxy war in Ukraine against Russia, began because of the refusal of capitalist governments around the world to take meaningful public health safety measures to deal with the COVID-19 pandemic.

Had they been initiated on a global scale from the outset, the virus would either have been eliminated or at least brought under some control. But the “let it rip” program, resulting in the development of new and more infectious variants, has disrupted global supply chains.

As part of their functioning within the capitalist market and profit system, commodity markets depend on the ability of traders to take out derivative contracts to protect themselves against sharp price rises and falls that can turn a potentially profitable deal into a loss-making venture virtually overnight.

But violent swings in prices have led to the breakdown of these mechanisms as financial entities, including the major banks, have demanded that traders stump up extra cash deposits, known as margins, before they will agree to providing loans with which they can finance their operations in the derivatives markets.

One of the most extreme examples is in the European natural gas market. Buyers and sellers must now provide around \$77 as collateral for each megawatt hour of gas they want to trade. A year ago, the amount required was around \$4.50.

The margin required for a four-month contract in Brent crude oil has risen to almost \$12 a barrel, more than

double what it was a year ago.

In a report on this phenomenon earlier this week, a *Wall Street Journal* article reported it had spread across the board.

“Traders and analysts say the added costs and heightened risk of trading commodities has dried up market liquidity—the ability to transact at expected prices without causing big moves or disorderly trading,” it said.

In a comment piece published in the *Financial Times* this week, financial analyst Karen Petrou, who has been critical of the Fed’s policies of boosting financial markets because it has led to widening social inequality, indicated that it and other central banks may have to go further in providing financial support because of the chaos and volatility in commodity markets.

She noted there had been “liquidity stress” brought about by the increased demands for collateral and recalled that last month energy traders had written to the European Central Bank for assistance, noting that the situation was “just as serious in the US.”

While banks had provided some assistance, there were signs that the “dash for cash is accelerating.”

She also pointed to the risks in balance sheets around the world which is “mostly hidden from view.”

“Eerily reminiscent of the collapse in the 1990s of Long-Term Capital Management, the implosion of hedge fund Archegos last year was a lesson in how seemingly small exposure to leveraged speculators can cost systemic-scale banks serious money.”

The major Swiss bank Credit Suisse lost \$5.5 billion because of the Archegos collapse with the Japanese finance house Nomura taking a hit of around \$2 billion.

Petrou noted that while stress tests applied to big banks measured some market risks, none of these “approaches the price volatility of current core markets or its downstream credit risk.”

She warned that market disruptions that even approach

systemic risk will have a profound social effect.

“Millions of people across the world may find it impossible to feed their children and the work essential for economic stability will be out of their reach. Millions more will reduce their spending to handle basic consumption.”

But she advanced no solution, simply calling for the Fed to intervene in commodity markets lest “everything around it disintegrates into macroeconomic collapse and political fury.”

The commodity market chaos is beyond the financial system and extends into the physical world.

According to a report published in the *Financial Times* this week: “Stockpiles of some of the world’s most important industrial metals have dropped to critically low levels as record power prices in Europe hit production and the war in Ukraine threatens output from Russia.”

It noted that inventories of aluminium, copper, zinc and nickel, four of the main commodities traded on the London Metal Exchange, had dropped by as much as 70 percent over the past years.

Rising power prices have caused major companies such as Glencore and Trafigura to cut back production at loss-making zinc and aluminium.

The FT cited a recent report by Morgan Stanley analyst Marius van Straaten, who warned in a recent report that “current power prices could drive more smelter curtailments.”

Goldman Sachs has said that copper also would be “sleepwalking towards” a situation where inventory runs out and that the lag in the supply of refined copper compared to demand—some 375,000 tonnes this year, double a previous estimate—may be large enough to deplete all available stocks by December.

Global trade is also being hit, with the World Trade Organization predicting that its growth rate could be down by a third this year, warning that the decline in food commodity exports as a result of the Ukraine war would bring mass hunger in poorer countries.

Exports from South America will decline this year, while Asian export growth is expected to slow to 2 percent this year compared to 14 percent growth in 2021, with the export growth rate from Europe set to fall by more than half in 2022.

The growing turbulence is also expressed in the stock and bond markets. While Wall Street has not plunged, there is a general downward trend, particularly in high-tech stocks on the NASDAQ index which are sensitive to interest rate increases that the Fed is moving to

implement.

At the same time bond prices are falling, reflected in the rise in the yield on 10-year Treasury bonds. (Prices and yields have an inverse relationship.) The yield is now at more than 2.6 percent, well above the levels of around 1.5 percent a few months ago.

Normally the stock and bond markets move in opposite directions as money shifts out of equities and into government debt, raising the price of bonds and pushing their yields down. A move in the same direction is rare.

Many investment funds operate on a 60/40 ratio—60 percent in stocks and 40 percent in bonds. But as the FT noted, “this model now faces some serious strain,” with one analyst cited by the newspaper describing conventional portfolios as being in “big trouble.”

US inflation is continuing to surge with the latest consumer price index recording an 8.5 percent increase for the year to March. Further increases are to come because the producer price index for last month rose 11.2 percent, well above the expectations of economists.

The perception that the Fed will move to significantly lift interest rates throughout this year is leading to predictions of a recession. A survey of economists conducted by the *Wall Street Journal* this month put the probability of a recession sometime in the next 12 months at 28 percent, compared to 18 percent in January and 13 percent a year ago.

JPMorgan Chase CEO Jamie Dimon has warned that rising inflation and the war in Ukraine contained big threats to the US economy. “Those are very powerful forces, and those things are going to collide at one point. No one knows what’s going to turn out,” he said, adding that while a recession was far from a sure thing, it was “absolutely” possible.



To contact the WSWs and the
Socialist Equality Party visit:

wsws.org/contact