Global Strategy Weekly

Is the commodities collapse a canary in the coalmine or gorilla in the mist?

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Two weeks ago we wrote that the slide in commodity prices was starting to look eerily like 2008, but the past two weeks has seen a stunning collapse. And it's not just within the industrial metals complex, with copper down some 25% in just a month, but also most surprisingly, agricultural prices. This is not so much a canary in the coalmine as a rout. Just as in mid-2008 I now see the recessionary gorilla charging towards us out of the mist.

- The commodity complex is now seeing a collapse in prices, and this shows great similarity to what we saw in mid-2008. Although the oil price decline is slower and lagging, likely because of the Ukraine war, other industrial commodity prices are in virtual freefall. Soft-landing advocates must now face the overwhelming evidence of economic collapse and extricate their heads from the sand.

- Despite the fallout from the Ukraine war, agricultural prices too have also imploded, and that will sound a note of caution for those who think the oil price cannot fall as quickly as other industrial commodity prices. With the oil price having slid from $125/b to under $100 in a month, it should not be long before the yoy comparisons are negative, as with food prices.

- Headline CPI inflation will likely turn negative, and the inflation narrative will then evaporate (temporarily), so trigging a collapse in US 10y yields back below 1%. What a shock that will be!

- Before I dive into some charts on inflation, I just wanted to do a bit of advertising. That's because I'm very much looking forward to my discussion with Grant Williams on *'The Inflation Outlook (Still!) Holds the Key to our Investment Future'* at the Societe Generale and Risk.net Derivatives & Quant Conference, taking place on 13 & 14 October. I will be having a 'fireside chat' with Grant Williams, editor in chief of *'Things that Make You Go Hmmm'*. I'm looking forward to a free-wheeling discussion with Grant. For the full agenda and complimentary online or in-person registration to my session with Grant which is at 2pm London time on Thursday 13 October, click here: https://derivatives-quant-societegenerale.open-exchange.net/.

Global asset allocation

%	Index	Index neutral	SG Weight
Equities	30-80	60	30
Bonds	20-50	35	50
Cash	0-30	5	20

Source: SG Cross Asset Research

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The collapse in industrial metals prices over the past few weeks has been spectacular. Most attention has focused on the copper price as it is seen to be a bellwether for the health of the global economy, but the collapse has spread rapidly throughout the industrial metals complex.

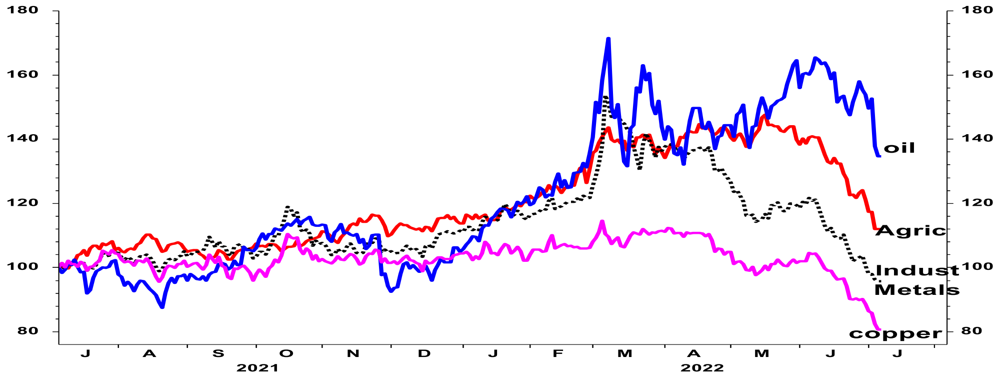
Commodity prices have slumped in the past couple of months

Commodity	May Peak Closing Price	July 5 Current Price	% change
Copper	4.35	3.43	-21.1%
Aluminum	2,956	2,377	-19.6%
Zinc	3,965	2,984	-24.8%
Nickel	30,975	22,138	-28.5%
Tin	40,616	26,600	-34.5%
Lead	2,281.50	1,957.50	-14.2%
WTI Crude	117.61	103.42	-12.1%
Natural Gas	8.97	5.56	-38.0%
Corn	813.50	588.40	-27.7%
Wheat	1,277.50	823.50	-35.5%
Soybeans	1,737.50	1,460.60	-15.9%

Source: Marshall Auerback, @Mauerback

There are times in economics (and here in the UK, in politics) when it is obvious the game is up and it's time to get your head out of the sand.

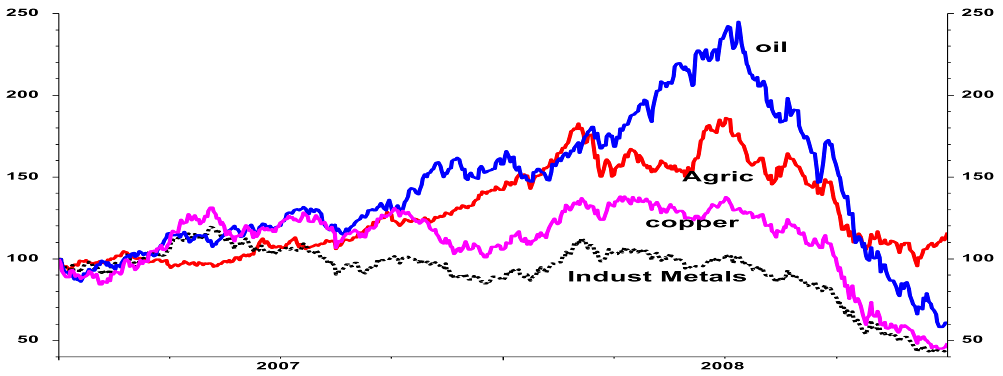
Copper leading the way down - slumping 20% in the past month alone (indexed to 100)



Source: Datastream

All these data are consistent with the global economy plunging into a deep recession. Soft-landers (now as rare as flat-earthers) claim that this is just excess speculative froth being blown off, but the bulls said that too in 2008 and look how that ended up!

In 2008 industrial metals led the collapse in agricultural and oil prices (indexed to 100)

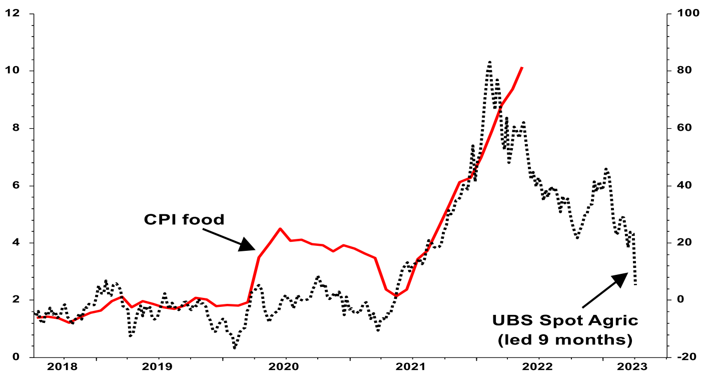


Source: Datastream

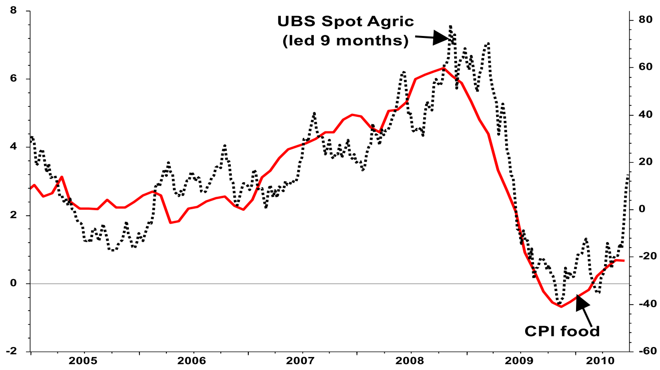
For those who believe this collapse is due to hedge fund speculative positions being closed, I invite you to check out Ed Yardeni's regular updates on the CRB Raw Industrials Spot Index, which minimizes the influence of hedge fund speculative activity on that index. It too has slumped. I actually also heard someone say the level of the copper price was still too high for there to be a global recession. What nonsense! It is the *rate* of change that matters, not the *level*.

One thing that surprised me though is that agricultural prices are falling as fast as industrial metals. Is that due to long speculative positions unwinding? Or is it like a decade ago when QE2 'triggered' the Arab Spring, where agricultural prices were not just driven by fundamentals, but by QE. Are falling commodity prices now driven by QT - just like the repo market blew up in 2019?

US CPI food price inflation is about to peak and fall...



...and we could be set for a repeat of the 2009 deflation



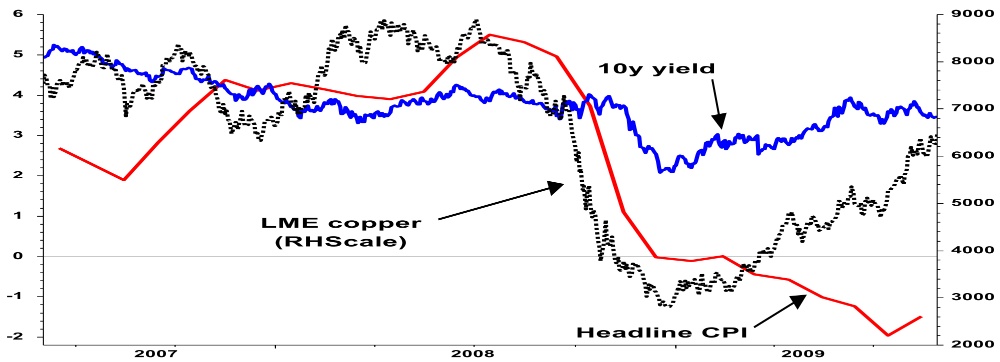
Source: Datastream

The long and the short of it is that US CPI food price inflation is set to collapse into yoy deflation, just as it did in 2008/9 (see chart above). The same thing should happen with oil if there is a global recession despite the war in Ukraine. Oil prices this time last year were between $75-80/b, so it won't take much of a fall from here to get into a yoy deflationary environment.

And that will be the big surprise in the next six months. As commodity prices slump – reflecting the unfolding global recession – headline CPIs will collapse around the world, and with them the inflation narrative (although the reprieve might prove temporary).

But just to quickly remind ourselves of the power of 'Dr Copper' to accurately spot an ailing economy well ahead of economists, let's look at what happened in 2008 in the chart below where headline CPI fell from 5½% to below zero in just a few short months. The secular story might have transitioned away from the Ice Age to the Great Melt (where the cycle will bring higher highs and higher lows in interest rates, bond yields and inflation), but first a cyclical bust awaits and that will feel very much like a full-blown return to deflation.

Headline CPI inflation could collapse surprisingly quickly just as it did in 2008/9



Source: Datastream

APPENDIX

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