Zoltan Pozsar: “The World Changed 12 months ago.“

Commodity Super-cycle Explained

VBL

APR 19 · PAID

SHARE

In Zoltan Pozsar’s most recent interview pursuant to his missive entitled War and Peace, he spoke with Resource Talks in mid March. During this conversation, he laid out rather cleanly the main points of that report entitled War and Peace. So we listened and wrote a follow up to that piece outlining Zoltan’s key points.

Video: Resource Talks

Contents:

6. Rate Hike Recession Effect Summarized
7. How Long a Supercycle?

Zoltan Whispering Below:

Attached is a blow by blow of key concepts broken out, intended to be used as a follow along while listening or a stand alone post. It is Pozsar's points broken out chronologically in what should be an easier to digest flow.

This will be our only post today.

Enjoy

Intro: Commodity Narratives for Interpreting Rate-Hike Regime Effects

There are Two Narratives Surrounding Commodities when Rate hikes commence.

Narrative One:

- High prices combined with rate hikes will crash them, as the Volcker era demonstrated
- Supportive of this was what happened in the 1970s when you also had the market responding to higher prices incentivizing more supply growth.
- 2008 was a similar effect due to supply side growth and liquidity collapse.

First Narrative Summarized:

The first narrative sees a decrease in demand from rate hikes in combination with an increase in supply from more production eventually crashing commodity prices.

Narrative Two:

There is a second narrative. The one that says commodity prices will not drop due to rate hikes.

- That narrative says today is different even though we are raising rates.
- The three things more influential over Commodity prices they relate hike during this narrative are…
- Lack of supply side investment, Geopolitical tensions rising, and the EM changing “body language” regarding natural resources.

Three Things Governing the Second Narrative

Supply side investment, Geopolitical tensions rising, and renegotiating EMs

1- Supply Side Investment:

- Production is not increasing for various ideological (ESG) and economic (poor capex investment) reasons governing respectively; firms’ longer term business viability and their short term profitability.
- E.G.- Majors in oil are buying stock back due to uncertainty on if they will even be permitted to drill for oil 10 years down the road.
- Other types have no desire to expand operations to take advantage of higher energy prices, choosing instead to lay back to placate nervous investors’ desire to recoup losses.
- All these things sap future production coming online. (note, our writing colleague Brynne Kelly saw this manifesting in longer dated oil future prices elevating months ago)

This also undermines the traditional concept of “the cure for high prices is high prices” from economics 101. The feedback loop for supply-demand elasticity is broken.

The 1970s was about oil alone. This is about Oil and Gas.. and even other things as well.. Copper, lithium, are effected.

2- Geopolitics:

Geopolitics is back on stage.. it is what it is. But it is an upside risk now where as it has a calming effect in the past. In the past, there were no supply shocks from Geopol on supply chains. Now, that's all they seem to do..

3- EM Body Language Changed:

Body language matters. Mercantile practices and tariffs are now being used to protect the value of EM resources.

- EMs don't just want to be a part of the supply chain anymore, they want to be part of the value (added) chain.
- E.G.- you cannot export our lithium anymore. But if you build a battery factory here, you can buy it, process it, and export finished products

Next Zoltan addresses the anticipated recession from rate hikes due to demand destruction.

Rate Hikes in the New Narrative

- Recessions kill consumer demand, but they usually also kill company investment
- This time, in narrative two, governments are doing the capital spending [we would note that during Volcker, government was coming off a spending excess and fiscally pulling in its reins]
- They are sinking trillions into 3 themes that will negate the recession effect in commodities, and in certain industries
- Companies will be incentivized to match them

G7 Government Spending's Three Themes

Rearming, Reshoring, Energy transition.

Taken in combination examples of these would be:

- Building factories for batteries, Chips, subsidizing energy transitions,
- Military expansion in Japan, Europe etc, inventory mgt increases. Onshoring of factories etc
- All of these amounts are government money. It will be matched by company money as well

This will cause Two Outcomes

1. Commodity prices will remain high from constrained supply and increased expenditures

2. We are at the beginning of a domestic infrastructure investment renaissance

Notable:

> *'The investment portion will be quite powerful, perhaps to the point of us not even having a recession'*

The 3 Gov't themes will push counter the recessionary forces that undoubtedly accompany rate hike regimes. Consumption will get crushed. But investment will grow.

> *All these things are being done with a sense of urgency as (economic) national security and sovereignty is a big factor in each.. we need to do it yesterday*

Rate Hike Recession Effect Summarized:

Supply side constraints plus a golden age for demand (so to speak) are converging

We are in a commodity Supercycle in embryonic form. If geopolitics gets even more complicated you set the table for an even bigger price rise.

- Reshoring, rearming, and energy transition themes all just started getting traction 12 months ago
- 1970s was oil, this is a commodity crisis
- price to capital signal worked then, not now
- industry to do the energy transition are just being built
- Similar geopolitical pressures like the 1940s as well- emerging vs incumbent powers
- nat resource problem for us, is a technology problem for them

One thing that unites all nations East or West now is this:

- Countries will now put money into industry that facilitates self-sufficiency. Where they are weak, they must become strong.
- This is part of a collapsing globalization situation. Reduced complexity and self sufficiency are part and parcel of this
- The Fed-engineered housing and demand recession will be likely offset by an industrial revival. No recession is possible.
- Commodity Supercycle is definite.

How Long?

Commodity Supercycles last a long time

- 5 years at least
- Step up in demand
- Neglected supply side
- not seen like this in 100 years
- It is all being done in a rush, geopolitics is no longer calm, it’s an upside driver

GoldFix Comment: consume less, invest/save more.. manufacturing will rise, consumption and financialization will drop. The unwinding of the post Volcker Goldilocks Era.