Déjà vu all over again for commodities?

Black Swan Forex

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Is the Credit Crunch = Corona Crunch?

1. Attempts to reflate the real economy will fail.

2. We are stuck in the same paradigm, which is deflationary.

3. Will desperation lead to Weimar Republic this time around.
Key points from the chart:

• Credit Crunch stimulus drove commodities, currencies and metals sharply higher for two years (2009-2011) before it became clear reflation of the real economy had failed.

• We didn’t get inflation during that period (unless you consider it in the stock market).

• We won’t get it this time because more debt in the system is even more deflationary.

• Will commodities fall again-Déjà vu?
We are stuck in the same paradigm, but only with more debt and a weaker job market.

Mr. Market Isn’t Clearing
Or money isn’t flowing to productive assets to create fresh growth.

Locked into a nasty feedback loop.

Excess Borrowing
Created to much debt
Excess Spending
Led to Stagnant Aggregate Global Demand

Eight years on we see monetary & fiscal policy overwhelmed by debt overhang.

Four choices:
1) Accept regular boom/bust cycle
2) Accept secular stagnation
3) Munificient debt write-off
4) Accept outright government monetization

What was 2007-08 the debt crisis telling us?

* From 2016 webinar
You can lead a horse to water but you cannot make him drink.

“Each dollar of debt has generated only 13 cents of GDP growth for the past four quarters, compared with less than one-half of the 26.5 cents generated during the final four quarters immediately before the recession that started in late 2008.” – Hoisington Q2 Review & Outlook
The Deflationary Gap

“Assuming a large percentage gain in economic activity in the second half of this year, the Fed, the World Bank and many economists project that there will still be a substantial gap between potential and real GDP. In economic theory, this is called a deflationary gap. At the end of the three worst recessions since the 1940s, the output gap was 4.8% in 1974, 7.9% in 1982 and 6.4% in 2009. The gap that existed after the recession of 2008-09 took nine years to close. This was the longest amount of time to eliminate a deflationary gap. Even when the gap was closing over the last decade, the inflation rate continued to trend downward, remaining near or below 2%. This indicates that there were even more unutilized/underutilized resources than was captured by the magnitude of the gap. Considering the depth of the decline in global GDP, the massive debt accumulation by all countries, the collapse in world trade and the synchronous nature of the contracting world economies the task of closing this output gap will be extremely difficult and time consuming. This situation could easily cause aggregate prices to fall, thus putting persistent downward pressure on inflation which will be reflected in declining long-dated U.S. government bond yields.”

Hoisington Q2 Review & Outlook
But, it *may* be different this time.

If desperation grows from the US government/Treasury/Central Bank complex, we could swerve into **Weimar Republic time;** i.e. pure debt monetization.

“For the Fed to engage in true MMT, a major regulatory change to the Federal Reserve Acts would be necessary: the Fed’s liabilities would need to be made legal tender. Having the Treasury sell securities directly to the Fed could do this; the Treasury’s deposits would be credited and then the Treasury would write checks against these deposits. In this case, the Fed would, in essence, write checks to pay the obligations of the Treasury.”

--Hoisington Q1 Review & Outlook.

**Full monetization means:** The world reserve currency would plummet. Inflation would soar. And gold (and other commodities) would skyrocket. You can already see the relationship between the US dollar and commodities in the chart to the right.
LT Dollar Bear Market in the cards anyway?

Even if commodities prices were to correct lower once it becomes clear the real economy recovery has failed again, they should recover if our **long-term dollar view is correct**. Near-term, the US dollar seems extremely oversold. And a major sell off in risk assets would drive a dollar risk bid. The World Reserve Currency usually does well during periods of global deflation. So, a dollar bounce has the potential to last longer than we, and others, expect. But below is our **current technical view and some of the long-term fundamental rationales for a very deep dollar decline.**