

The pig is in the python.

I look at the rise in prices of basic foodstuffs, commodities and base metals in the last year.

Price increases for Selected Commodities from March 2020 to March 2021¹

Lumber 64.9%
Iron and steel 37.5%
Copper 73.4%
Fertilizer 25.6%
Crude Oil 26.1%
Cotton 34.8%
Ethanol 33.4%

Add to that the rise of container rates to move goods from one place to another.

And I see the pig in the python. The pig is higher prices. The python is the logistic and supply chains around the world.

And that pig is slowly moving through the python . . . slowly, inexorably and anyone who dares to look can clearly see that the pig is in the python.

And when the higher prices hit further down the chain, CPI will overshoot the most bullish expectations.

The second half of the price level equation, the velocity of money being hamstrung by Covid for over a year is now set to surge in a post pandemic splurge as people rediscover travel and hospitality services of all sorts.

The biggest question in my mind is why very few people are seeing the "pig" and all of the "python" and even those that do under-state the implications.

The reasons are not clear but let's look at who benefits by playing down the "pig". The government.

They want to inflate the economy for good reasons and bad, but they don't want it to overshoot on the upside. Why? Inflation over, say, 4% means they have to act to ensure price stability, a goal of the central banks around the world. The go to way of countering unwanted inflation is to raise interest rates . . . something that government definitely doesn't want because they are the biggest borrowers in the world and their interest bill will seriously hurt their financing plans, their vote getting boondoggles and profligate spending patterns. Nobody likes their platinum credit card taken away from them!

But like I am fond to say, life is not a wish granting factory. Inflation is moving through the logistic and supply chains and coming to a corner store near you.

What are the implications?

It depends.

If central banks react timeously (which they said they WON'T do)

- Interest rates will rise

¹ Data from Federal Reserve and Bloomberg

- Financial asset markets will fall as will property markets as the discount rate rises.
- Commodities and real assets will continue their rise.
- Inflation will eventually slow

If central banks don't react timeously (most likely scenario)

- Financial asset markets will carry on in their crack up boom alongside real asset markets.
- Increased Debt financing will accelerate making the economy even more fragile than it is today.
- Inflation will accelerate to levels we cannot imagine today.

In this scenario when central banks decide to play catch up to unexpectedly higher inflation with rapidly hiked interest rates, it is going to crater all asset markets.

This will be volatility asset's finest hour but few will cheer it, I imagine.

"sometimes truth stares us in the face but we choose not to look" Gill Lewis

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