QUICK NOTE: inflationary undercurrents from oil, pork & iron ore

There are some inflationary undercurrents coming through in some core commodities, which have important implications for global macro outcomes and policy responses. Prices in Iron Ore and Pork are threatening *4 year ceilings* due to some major and unresolved supply-disruptions (Vale dam disaster, weather & African Swine Fever) while Oil is near 5mo highs, and keeps strengthening (on inflationary inflows and the OPEC headlock). Bottom-up inflationary tailwinds stemming from these repricings is a theme that should be monitored, given that these are generally good proxies* for broad price pressures in the macro-economy.

Page 1 provide some takeaways & thinking around these inflation undercurrents
Page 2 outlines price action across, Iron ore, Pork, Oil & some key food and raw materials indices.

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- A floor has been put into global inflation readings with upside risks increasingly more of a worry given:
  - How **late we are in the US cycle** depicted by super accommodative Fed & CB policies, and persistently rising US equity prices & buoyed US wage inflation
  - The perceived **acceptance ('targeting') of inflation** by DM CBs, the historical (in)ability for the Fed to be ahead of the inflation curve, and the broadening talk of alternative CB policy tools (including MMT)
  - **Politics** (dovish Fed nominations, the pivot to the left, inflationary effects of global trade wars),
  - The potential (and unknown) effects of climate change / severe El Nino events

- **Inflation is complicated** by the fact that it comes at us in various forms; headline inflation—CPI—doesn't accurately capture other types of inflation seen in asset prices, real estate or education/health costs. There is arguably paper inflation (equities), and real assets – from copper to gold – become relevant as a hedge against the known rise in (asset price) inflation and the threat of this spilling over into other measurable metrics (like CPI); investors begin to position for the tail risk event of inflation simply happening gradually, and then all at once, and it is not a coincidence that commodities (BCOM) are probing key technical upsides at a time when global central banks are dispensing additional liquidity

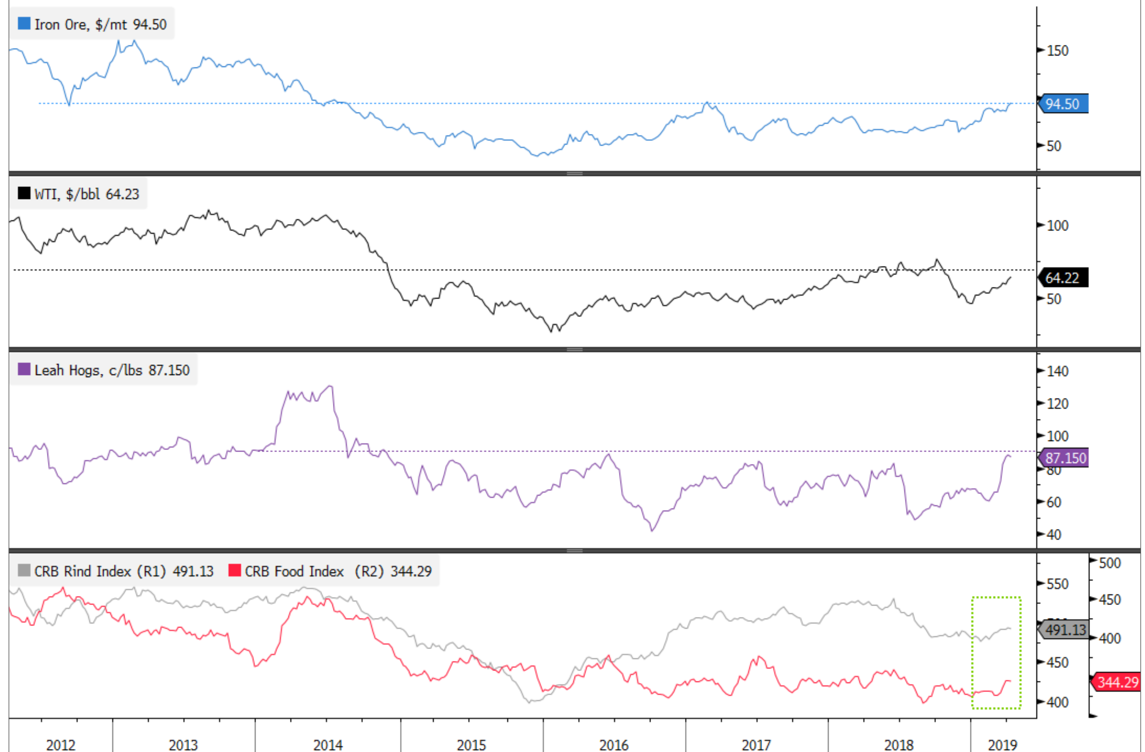
- **Stagflation** should be discussed, hedged and monitored given the *potential* inflationary impact of the rise in structurally important commodities and asset prices, as (if?) global growth has in fact rolled over. Theres been a series of growth downgrades by the IMF and CBs, with a broadening acceptance/realization that many economies are out of bullets (and missed their chance to hike) ahead of the next recession. This has forced a rethink of alternative policy tools, like MMT—which have unknown inflation implications.

- **CB Policy responses**: mistimed & complicated:
  - The Fed is fighting to inject inflation in part due to the indirect and lagged effects of the oil fallout in 4Q'18, at a time when crude prices are almost up 50% since the December low… Ultra accommodative Fed policies is occurring at the top end of equity markets/ wage growth and low-end of UE, which does not imply independence, no matter how you slice it.
  - Theres been parallels drawn between the Richard Nixon/Arthur Burns period in the 1970s (Burns was bullied into monetary loosening before the 1972 presidential election, sowing runaway inflation for the rest of that decade) and the recent Fed nominations (Stephen Moore & Herman Cain) by Trump, as both arguably lean dovish.
  - Given the inflationary tailwind from ASF on food prices, theres a risk that EM economies (not only China) revise up their inflation expectations going forward, which could ultimately halt any accommodative policies if these measures begin to brush up against targets (eg: PBOC at 3%). China releases CPI tonight which could see the deceleration (from its peak in October 2018) reverse, given the contribution from pork pricing. However, speculation that this supply shock might trigger a rate hike, is too early. With growth broadly slowing, other weak inflationary measures (PPI) , and a banking system in need of liquidity, a mild pickup in the CPI wont reverse PBOC policy.

- While the bottoming out in inflation readings may not be directly very bullish for **gold** *now* (many goldbugs were wounded over the past 5+ years buying gold as an inflation hedge), it highlights and justifies why
  - Gold prices have held around $1300 and have not reverted back to $1200 given the rebound in macro optimism, risk assets and equity prices.
  - Theres been relatively strong Gold inflows YTD from both investors (ETFs) and sovereigns (Central Banks).

- **IRON ORE** (panel 1) : Iron ore prices have increased >50% in 4 months, back up toward $100/t (cyclical highs) on Australian cyclones, the collapse of the Brumadinho dam at Vale mine, a derailment of a BHP iron ore train and a fire at a Rio Tinto's export terminal. Last week, BHP & Rio said Veronica will knock between ~3%-4% of their 2018 production out, while Vale said it Brumadinho will cut 75m mt of Iron Ore (out of ~380m mt they produce) in 2019. Theres upside risk to supply loss forecasts given ongoing legal and regulatory battles for Vale which could experience a prolonged halt of operations at some IO mines and general ramifications for an industry that could slow new projects. Australian and Brazilian IO exports have plummeted, analysts have revised up IO forecasts and the market is scrutinizing known inventories (low seaborne availability, vs decent port inventories) just as IO prices (on Chinese exchanges) scale $105/mt equivalent.
- **OIL** (panel 2) is up >50% YTD and at 2019 highs: further Venezuelan disruptions, and potentially more sanctions against Iran could deepen an OPEC-led supply cut. Oil continues to attract inflationary-driven (paper) inflows in 2019 with COT positioning rebounding strongly off of cyclical lows; the news that Aramcos IPO will be the largest bond offering in EM history reinforces that there is *still* a long-term investment case to be exposed to Oil/the Gulf...

Core commodities
probing upside ceilings



Source: Bloomberg, Scotiabank Commodities Strategy

IOECAU62 Index (Iron Ores Fines 62% Fe Offshore Export Price Australia to China Copyright© 2019 Bloomberg Finance L.P. 10-Apr-2019 11:39:28

- **LEAN HOGS** (panel 3) are up over 40% in 2 months taking prices to 4year highs due to African Swine Fever (ASF - a fatal disease sweeping across East Asia which has cut stocks of pigs & sow to 2011 level and forced China to cull ~1m hogs, ban the transportation of live hogs and close trading markets. Pork prices have large implications for 1). Chinese (and EM) inflation given food prices are the largest factor in consumer inflation and the main component is pork*, 2) the general agricultural / livestock supply chain. In both 2006-2088, and 2010, rising pork prices ignited stronger Chinese inflation and spurred the PBOC to hike rates. While there are parallels, the current inflation/growth environment is quite different.
    - **CRB Rind** (panel 4) - a raw materials index of goods that doesn't have a paper outlet and **CRB Food**, are only up in the single digits YTD, thus they're not pointing to accelerating inflation (yet). However, they have rebounded strongly off cyclical floors and given the tailwind from ASF, theres upside risk to these indices and a risk that other economies (not only China) will revise up their food-inflation expectations going forward.