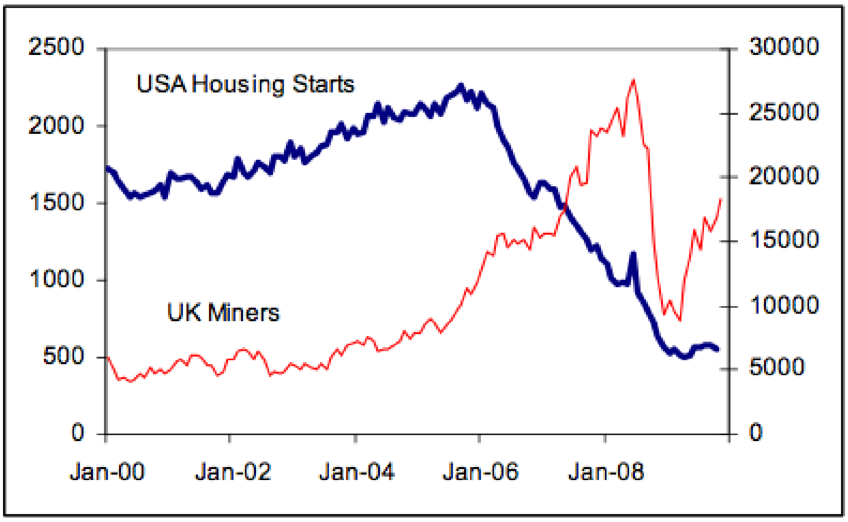
# Citi: The Commodity Collapse Could Be "Subprime Part II"

Joe Weisenthal|Nov. 23, 2009, 5:34 PM

In the bank's latest edition of its Monday Mining Minutes, Citi lays out a scenario which it calls the "Nightmare on Commodity Street." (via FT Energy Source)

> So here's the nightmare scenario, which we hope will not happen: Thousands of very smart speculators have accumulated the biggest ever speculative physical raw material positions ever witnessed in the belief that either the dollar will collapse or an ongoing global 'Supercycle' will shake off the effects of the credit crunch and resume business as usual. They are funded in this venture by some of the lowest interest rates on record. What are the threats to their thesis?. They are as follows :
>
> 1. Governments, having pumped huge amounts of money into the global system, find they are running our of fire-power even while economies are still at the incubation-stage of recovery (i.e. the kind of stage we saw displayed last week in the poor USA housing starts data). Some governments find that suddenly their bonds are considered to be 'toxic' and a far higher interest rate is demanded for ongoing participation.
>
> 2. The global economy not only experiences a slower upturn than the consensus view, but after the recent inventory-restocking phase is over, it relapses into a W-shaped recession. More jobs are lost and people who have been unemployed but still able to keep up their mortgage payments (because of near-zero interest rates) are suddenly defaulting. Banks finally have to write down the value of these assets and housing markets around the world are flooded with new inventory. New-build is out of the question. Orders for new fridges, washing machines, stoves, taps and other items that metals so depend on for demand, simply freeze.
>
> 3. The global commercial property market finally grinds to a halt. High-rise buildings that began to be built 18 months ago, before the credit crisis, are finally completed. Their last copper wiring and plumbing has been installed (always the last phase), their aluminium windows all in place. Few new high-rise buildings are started, awaiting the glut of space to be used up
>
> 4. China. A real conundrum. This is either a really vibrant economy that will keep going from strength to strength or it is an economy in which over-investment was constantly rewarded because underlying demand was always growing at a pace that subsequently justified that investment. There has been substantial over-investment in recent times and the question now is whether domestic demand and export demand will step up to the plate to belatedly justify that over-investment. Demand has done this with monotonous regularity in the past 10 years. The question is whether the global credit crisis has changed that demand profile forever such that over-investment results in ongoing medium-term overcapacity and sends a shock wave that freezes new investment. We will have to wait patiently to see if this threat comes to the fore.

**Figure 2. USA Housing Starts & Miners : Banking on an Uncertain Future**




Source: Datastream, Citi Investment Research and Analysis

If these threats come to pass, we will truly have a ‘Nightmare on Commodity Street’. The commodity space could resemble ‘Sub-Prime II’ and would demonstrate that investors never learned anything from the shock waves that descended on global investment in 2H 08. This is not a new feature of human nature. There’s a simple principle that operates at times like this: investors experience a huge bull market that takes asset classes from a value of 100 to say 300. A crash comes and investors find those assets trading at 150 and simply by virtue of the 50% fall, the assets are deemed to be cheap. Investors pile in and the inevitable funds-flow-fuelled price rise to 230 justifies the optimism, even while the fundamentals are not playing ball and supporting that 230 level.

http://www.businessinsider.com/citi-heres-the-nightmare-scenario-for-commodity-bulls-2009-11