Commodity Hyperinflation: Bomb At the End of Iran-War Fuse

by Paul Gallagher

A U.S.-British military attack on Iran is now a looming threat, under the imperial-war strategy Dick Cheney brought to this Administration. If the countdown is not stopped by the removal of Cheney from the White House, a war on Iran will turn what is already intense inflation in the markets for almost all industrial commodities, into an explosion. Another huge jump in the crude oil and oil products prices, triggered by a spreading new war in the Mideast, will hit already hyperinflationary markets for metals, plastics, chemicals, etc., and crush industry in the United States, Europe, and Japan in a blowout. This is one explosive shell of the bomb, for which Blair's and Cheney's war on Iran will be the fuse.

In a warning memo, "Hyperflationary Patterns," published in *EIR* last Sept. 30 and reprinted below with its crucial illustration, Lyndon LaRouche compared the "hedge fund-driven shock front" of inflation that he said was then striking commodities, to the midpoint of 1923 in Weimar Germany. That was the cycle that ended in a classic hyperinflationary blowout which left Germany's money worthless, and led to foreign government interventions which hastened Hitler's fascist coup.

The commodities-market events since then have proven both LaRouche's memo, and the distinctive "Riemannian shock-front" illustration he added to it (see page 18), to be entirely accurate. For the typical commodity widely used in industry, hyperinflation took off sometime between August and October of 2005—just when LaRouche was writing—and has since driven its price up 40-60% in less than half a year (see the charts), despite the lack of further oil price increases since October. The inflationary shock jumped to the next wave of commodities—copper, aluminum, iron, zinc, lead, tin, gold, silver, resins, chemicals, and even computer chips—just as LaRouche had it illustrated in his "conical shock-wave model." In every case, the pouring into these spot and futures markets of speculative bank-loaned and other hedge-fund capital, followed by private equity funds, and increasingly by pension funds, drove the inflationary shock.

The copper price made one lurid and typical example: By the end of October, large London-based hedge funds, pouring funds into "long" copper bets, had trapped a big Chinese trading company which was shorting the copper price (China is the largest user of many of these commodities); the consequences of the London funds' speculative victory triggered the price to zoom to an all-time high of $4,000/ton. Copper supply? Copper stocks on the London Metals Exchange are at their highest in over a year. Copper demand? It had fallen by 2% in the first half of 2005. But the price had risen by 65% from early 2004, and 25% since early 2005.

" 'Copper Peak' Due to Hedge Funds" headlined the London *Financial Times,* quoting a large bank's analyst: " 'The funds are going to try to hold the price up. This is all fund buying; that is all it has been. The hedge funds are self-fulfilling; they create the momentum and then they run along with it.' " But it was not a peak; within three more months, the price had jumped another 25%, to over $5,000/ton. Standard Bank of London issued a report on Feb. 7 which estimated, and no doubt underestimated: "Hedge fund and equity fund investments in commodities will rise almost 50%, to $120 billion this year [2006]," after rising 35% from 2004 to 2005.

If the hedge fund shock front again piles into oil and petrochemical spot markets and futures markets in the boiling heat of a new war—possibly involving nuclear weapons—in the Mideast, the hyperinflationary explosion will blow huge holes in what remains of industrial capabilities and agriculture internationally.

The Commodity Research Bureau's (CRB) international index of prices of all industrial commodities hit its all-time high (it has been compiled since the depths of the last Depression in 1934) at the beginning of February, and a *New York Times* report noted that "commodities have become the new

tech stocks" for private equity funds and hedge funds, referring to the huge global IT bubble which blew out at the end of the 1990s. The broad CRB index had risen 21% in the year since Feb. 1, 2005; by 13% in just the two months since Nov. 30, 2005; it had hit new record highs 31 times since June 2005.

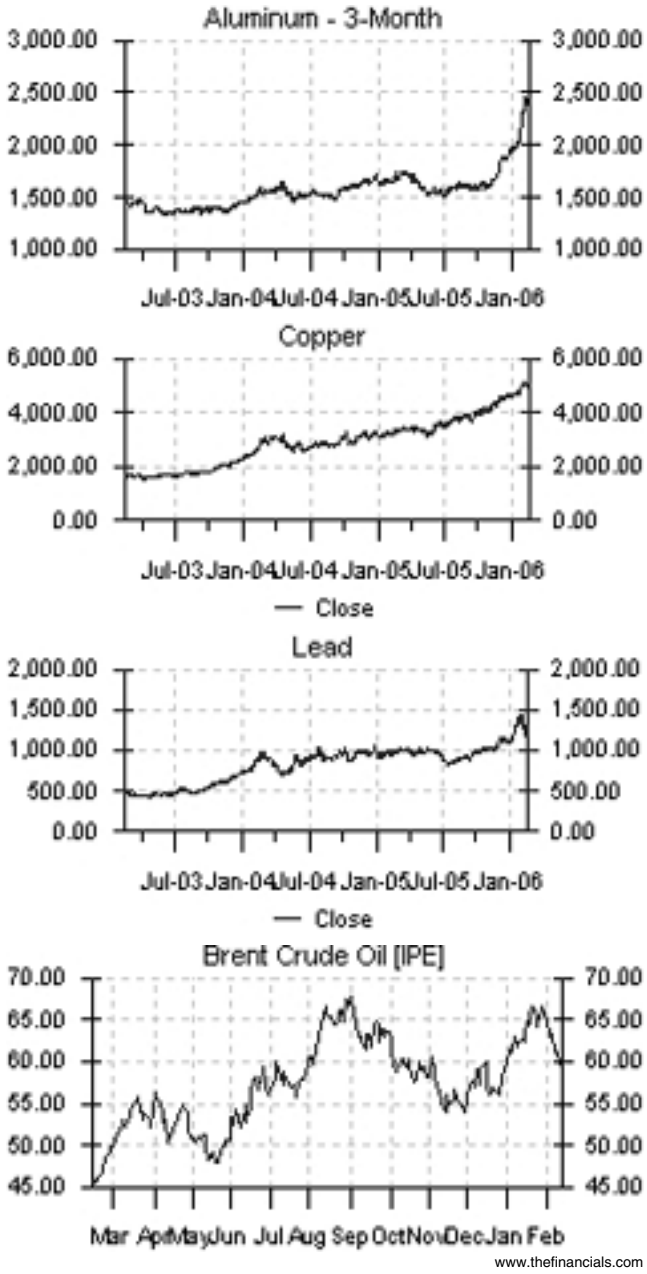
The world market price of iron, for example, escalated by 71% in 2005 and is rising by another 15% now by an agreement imposed by the three British Commonwealth producers—Anglo, Rio Tinto, and BHP Billiton—which dominate the global market. And since early 2004, the price of coal per ton has roughly doubled, to about $60/ton coming from the mine mouth. The combined result of this inflation? Worldwide production of steel, outside of China, fell for the year as a whole, by more than 1%. World prices for steel rose sharply throughout the middle of 2005, and were up 30% since 2003—hitting auto production, among others—though levelling off at the end of 2005.

Into that breach lunged the world's biggest steel producer, Mittal Steel, surrounded by a feeding school of hedge funds, to attempt a takeover of number-two Arcelor Steel; the purpose, as CEO Lakshmi Mittal makes clear, is to "rationalize the steel market" by further reducing production—getting hold of Arcelor steel mills and closing them, as Mittal has done with International Steel Group mills in Indiana, West Virginia, and Maryland. Thus, to resume the upward march of steel price inflation.

The world's largest hedge funds, based in London and New York, including GLG Partners, Cerberus Capital, and Perry Capital, piled into stock shares of Arcelor and Mittal in early February, in a publicized drive to force up the price of the merger by 25% or more—extract more capital from it. "Everyone in the hedge fund industry is looking at this deal," a London banker told the *Financial Times* on Feb. 5. By mid-February, the funds forced Arcelor to double its dividend, paying out 770 million euros ($920 million). The British government tried to threaten the French government to stay out, and make no efforts to block the hostile takeover.

Meanwhile, Mittal is attempting the takeover largely with bank debt, as it has the other purchases of older, less capitalized producers around the Third World and Eastern Europe; it counted on the hedge fund sharks coming in, and is working to bring them into the deal itself—in effect, borrowing some of the escalating takeover price from the funds. Mittal, which has been called "the next Parmalat" by one close observer, has just reported sharply fallen profits for 2005, and expects the same in 2006. Its huge accumulation of bank and hedge fund debt could blow more holes in the steel industry.

The same is true in plastics and other industrial chemicals. "Plastics prices continue to frustrate buyers in a wide swath of industries," *Reed Business Information* reported on Feb. 1, quoting industry supply-chain managers and buyers on 5-8% price increases in January for resins and plastic films. But as the typical chart for plastic mold ("blow") indicates, the price inflation for most plastics has been 60% from July 2005-February 2006. At the end of January, the plastics price index

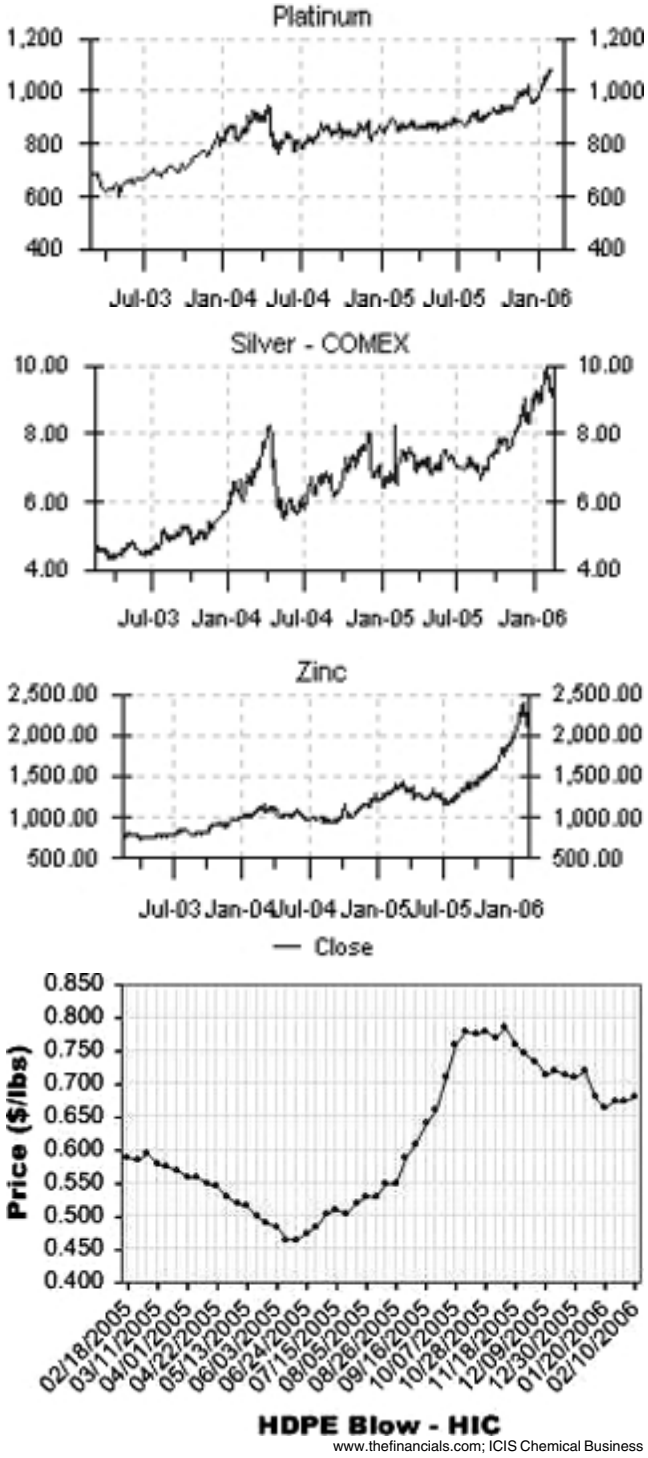


Aluminum, copper, lead: three out of scores of industrial commodities with 40-60% price inflation, driven by hedge fund speculation, since about September 2005, when Lyndon LaRouche's published memo warned "Hyperinflationary Patterns" stalked the economy. Note this was despite *a lull in oil price increases; Cheney and Blair's Iran war would change that dramatically.*

was at its highest monthly level ever, reported Purchasingdata.com.

The prices of many categories of distributed random-access memory computer chips (DRAMS) have risen by 25-30% since July 2005, with sharp jumps and dips caused by speculative funds plunging in the spot markets.

The hyperinflation has been strongest in the prices of metals, not only the precious metals gold, silver, platinum, but all



More examples: The surge in inflation in platinum, silver, zinc; and the price of plastic molds ("blow") shows the same hedge-fund-driven inflation has hit plastics and chemicals, as metals.

of the non-ferrous industrial metals, as well as iron and steel, as described above. Aluminum reached an all-time record, nearing $2,600/ton, a 55% increase from the $1,700/ton price at the beginning of 2005. This is another case, like copper, where supply-and-demand "fundamentals" are overridden. Stockpiles of the metal had been rising, the *London Times* noted on Feb. 1, with London Metals Exchange aluminum inventories at a 13-month high of 710,000 tons. Global aluminum output was a record 31.5 million tons in 2005, up 6.8%. World demand has been flat.

As is clear from the charts (pages 15-16), the Fall of 2005, when LaRouche issued his memo, was a breaking point. The price of lead rose 55% from September 2005 to February 2006; gold rose 22% in that period; copper, 44%; aluminum, 50%. Tin rose 30% in price from December 2005-February 2006; and zinc rose 100% from August to February. There has also been a funds-bubble in sugar, speculating on its use in producing fuels, which pulled its price up to a 25-year high.

The farther the inflationary wave has gone, the farther into futures has speculative fund capital poured. A *Financial Times* article on Feb. 15 reviewed the highly unusual situation which has developed, where prices of industrial metals for long-term delivery, such as five-year contracts, were rising faster than spot-market and short-term futures, and pulling the latter up. Between Nov. 1, 2005 and Feb. 1, for example, the price of aluminum for delivery three months in the future rose from $1,980 to $2,500/ton, or 26%; but aluminum for delivery in five years, rose from $1,700 to $2,400/ton, or 41%. Companies producing the metals are not leading this speculation, because their prices are rising so fast that they have stopped buying future "hedges" for fear of undershooting what the price will rise to. Instead, they prefer to sell their production on the current spot markets. It is the hedge funds and equity funds which are doing the short-term and longer-term speculation, driving the prices upward. Hedge funds are increasingly pulling pension funds into this long-term commodities speculation, dragging them toward the precipice of a blow-out which can destroy their workers' retirement assets.

The case of Mittal's hostile bid for Arcelor shows that the process of the speculation by hedge funds, acting in teams, forcing mergers and acquisitions—or, in some cases, break-ups of targetted companies, which are then acquired in pieces—is just as advanced in the industrial commodities markets as in others. The results are that production of the commodities is held down or reduced, and industrial prices rise further. For finished aluminum-ingot products, for example, there was an average rise of 6.4% just from the third to the fourth quarter of 2005. Alcan, the world's second largest producer, bought Pechiney Metals (Montreal) and Novellis Metals during 2005; Alcan also closed down several of its mills in Europe and one in Canada. It thus plans to see a global deficit of 300,000 tons of aluminum, below demand, in 2006.

For copper and nickel, a new world's-largest producer is being formed by the merger of British Inco Ltd. and Toronto-headquartered Falconbridge Ltd. This $12.1 billion merger will be larger than Norilsk Nickel in Russia. A notable feature: Falconbridge mined 7.4% less copper in 2005 than 2004, and sold 4.6% less, even while prices were zooming to all-time records; it mined 22% less nickel in 2005.

When petrochemicals and metals prices suddenly took a plunge from Feb. 8-15, it was reported that governments were trying to intervene against the growing hyperinflation, by raising interest rates. The Japanese government leaked rumors on Feb. 8 that it would abandon its effective zero-interest-rate policy—setting off a commodity-prices drop—though it then denied taking any immediate action. U.S. interest rates have been rising through February. But the financial locusts were simply dumping metal and other commodity futures temporarily to speculate in interest rates.

Governments could exercise greater force against the hyperinflation by intervening to stop the Mittal takeover of Arcelor, as a signal that the galloping monopoly mergers in coal, aluminum, copper, steel, and other industries might be undone. But the dumping of Dick Cheney would be a more powerful step, because what is necessary above all, is to prevent an attack on Iran from triggering $100-plus/barrel oil and a completely uncontrollable hyperinflation.

Hyperinflationary Patterns: Inflation Runs Wild

by Lyndon H. LaRouche, Jr.

First published in EIR*, Sept. 30, 2005.*

The world is presently gripped by a hyperinflationary wavefront of a Riemannian type. The situation is already comparable, at its primary-commodities "spear point," to Germany during the second half of 1923, with the other categories, such as consumer prices generally, on the way to being driven to overtake the effects seen currently in the domain of primary commodities being led, as a pack, by wild-eyed petroleum-price speculation.

Think of the way in which a "sonic boom" moves across the landscape, with its point running ahead and the effects on the ground coming up afterwards as the conical front of the wave moves onward. Think of a shaped-charge detonation "seen" from the "inside."

From that standpoint, the system as a whole is already in a state comparable to some point in the second half of 1923 Weimar Germany. We must estimate the general shape of that monetary-financial-economic "sonic boom" front's movements, slightly understating the actual effects for the sake of not stumbling into accidental overestimations which might impair the credibility of our warnings. However, consider the hyperinflationary explosion fully on, in ways comparable to the second half of 1923.

Beyond that broad-brush, historical view of the matter, there are significant differences in detail which we must recognize.

The leading edge of this rising hyperinflationary panic is the hedge-fund crisis centered in hot spots such as the Cayman Islands (where Satan spends his weekends visiting his closest human relatives, and their money). In the attempt to bail out of the Spring bubble's collapse, the hedge-fund money focussed on hyperinflationary gambles in primary materials, led by the control over petroleum markets. The attempt to turn vast masses of newly generated fictitious liquidity into apparent profits in commodities, that at rates sufficient to stave off the inevitable collapse of their monetary-financial system, a shock-wave-front-line acceleration of primary materials rise, led by petroleum prices, moved like an accelerating supersonic vehicle across and above the landscape below, sending

Shocks in Unsound Economies

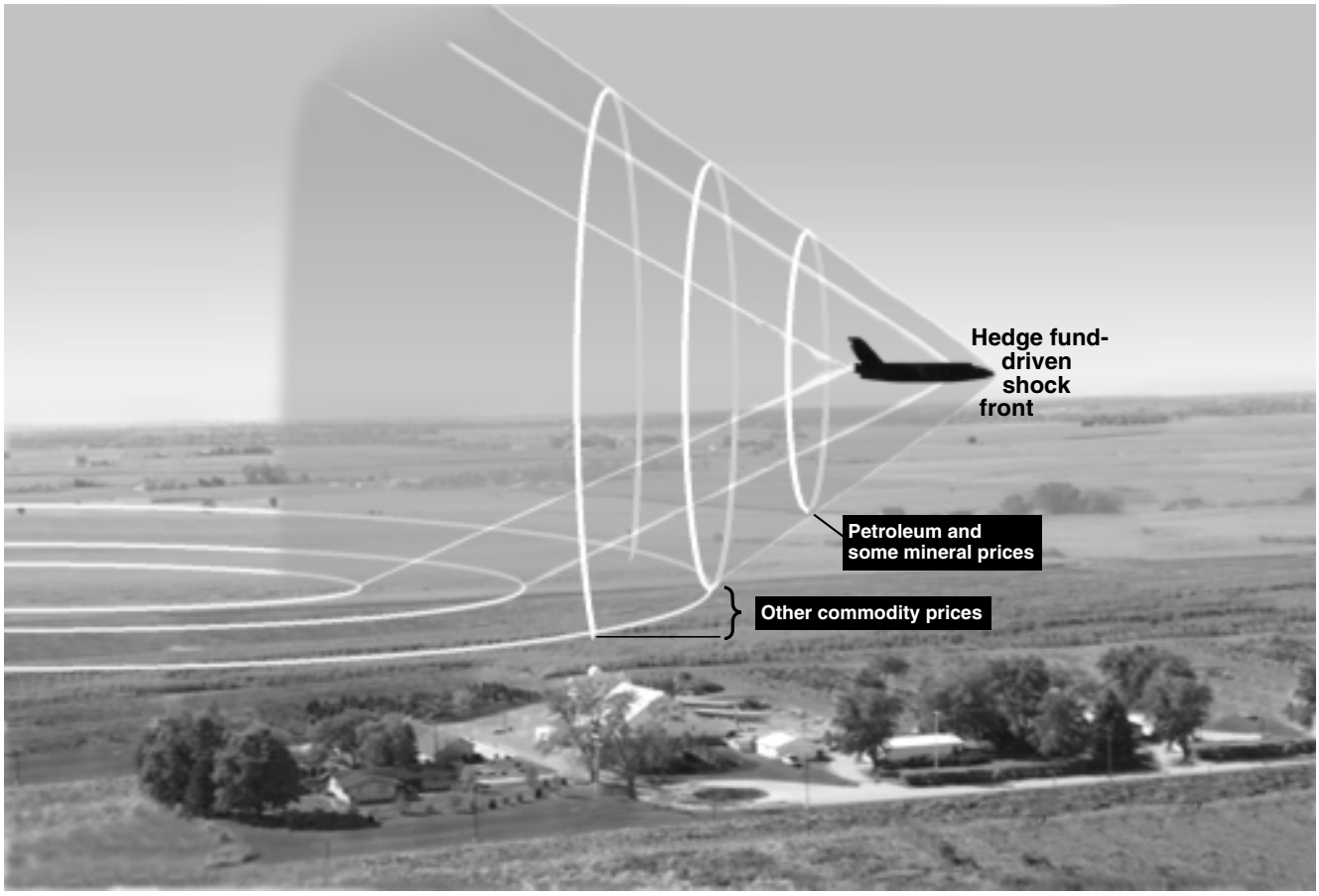
Excerpted from a memo published in EIR*, Sept. 30, 2005.*

In both the present case, as in 1923 Germany, a hyperinflationary explosion was building up over an extended period. In this case, the origin of the condition which caused this chain-reaction-like present explosion of primary commodities and other prices has been building up since the mid-1990s, with the subsumed points of inflection of 1997-1998. Ironically, the measures used to control the aftermath of the LCTM hedge-fund crisis, actually created the preconditions for the explosion which has now occurred, that in a manner similar to the way a building-up explosion of prices was contained until approximately the middle of 1923, when the explosion of the wild hyperinflation then occurred. A condition of "overload" was approached, akin to the discomfort of the supersonic aircraft (or would-be supersonic aircraft) as it approaches the relevant boundary-condition of the process.

Thus, this present hyperinflationary outburst has been building up since the immediate aftermath of October 1987, when the U.S. economy slipped into the implicitly hyperinflationary mode launched under Alan Greenspan's assumption of the post of Federal Reserve Chairman: a point in the process comparable to approximately May-June 1923 in Germany has already been reached. The attempt to bail out the hedge funds has triggered the shift from contained hyperinflation to explosive hyperinflation, a critical, uncontrollable phase of the present system, a phase comparable to a Riemann shock-front has been entered. Without a sudden change in the system, as Riemann's work implies, the world economy is now doomed to an early and ugly, chain-reaction collapse.—*Lyndon H. LaRouche, Jr.*

FIGURE 1

LaRouche-Riemann Conical Shock Wave Model of Hyperinflation



The present hedge-fund-driven hyperinflation is comparable to a sonic boom moving across the landscape. At the tip of the cone, where the shock front forms, is the speculative bubble in hedge funds and related derivatives, orders of magnitude larger in monetary value than the physical economy. The commodity price inflation, led by petroleum and certain minerals, is dragged along in the opening conical tail. Prices of other commodities and consumer goods lag behind in time and are diffused as they spread out in the conical opening. As in the Gauss-Riemann representation of the complex domain, visible or empirically determinable measures (in this case prices) are actually being determined in the non-visible, complex domain. A Riemann-type shock front forms at the cone-shaped boundary layer where the rate of increase of out-of-control speculation confronts the declining rate of real physical economic growth.

shattering shocks to the land-based economy as the trailing edge of the cone touched land below.

Thus, the rate of inflationary rise of prices of petroleum and related primary commodities now, is the rate which is already in the process of striking commodities on the land below the passing of the hedge-fund-drive hyperinflationary shock-point. That is the gist of the way in which you must think about this situation. What is hitting in the petroleum-price domain is the current trend of onrush of prices of all commodities in general. Do not commit the blunder of measuring price-changes from the ground up; the rate of change on the ground-level is actually the rate of change expressed as oil-price inflation.

The conical function [the graphic on this page—ed.] is a simulation of a higher-order actual process; but, the general effect of a conical function is correct, nonetheless.

There are several ways in which this could be refined. All proceed from the fact that it is the rate of acceleration of the price-inflation at the nose-sector (the apparent point of the cone) that is the determinant of the rate of hyperinflation. The actual hyperinflation is generated in the financial-derivatives sector prior to the oil-price-zoom effect (an area of high turbulence in at the front of the tip of the first commodity-transaction, e.g., petroleum). The characteristic which defines the hyperinflationary rate is the rate of acceleration relative to the normal price-commodity turnover in the economy. Hence the relationship of increase of speed, measured in "Mach-number"-like increments, to the "speed of sound," the resonant rate of commodity turnover in the base-economy relative to petroleum primary commodities.