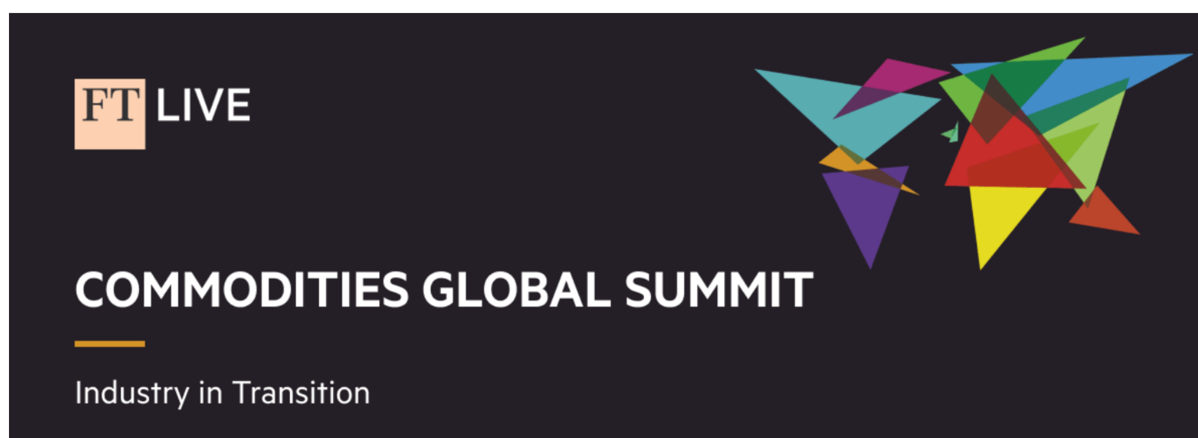

(Held on the 21st, 22nd and 23rd of March 2023 at the Beau-Rivage Hotel in Lausanne)

For the 11th year, the commodity industry gathered in the lavish Beau-Rivage hotel in Lausanne to take stock of the market conditions, reflecting on a quite extraordinary year 2022 and trying to identify how the immediate and longer term future might pan out. The FT journalists gathered an impressive array of speakers, sometimes put on the spot with a slightly more pressing tone than the previous years. This maybe reflects the zeitgeist amid concerns about what is perceived, notably outside the industry, as too slow an energy transition, together with worries about the impacts of a lingering Ukrainian war. And more broadly, amid the uncertainty of the consequences of an increasingly more polarised geopolitical world, bound to affect a well-oiled system of highly integrated supply chains across the globe.
In front of over 500 attendees as well as a virtual attendance of around 100 people, 70+ panellists endeavoured to shed some light on markets dynamics, risks, and opportunities. Following are some thoughts about this extremely fruitful exchange of views.

Let start with what was not discussed however: the possibility of a global recession. Was it because commodity trading has been so successful over the past two years despite (or thanks to) a most uncertain environment, or because the first few months of 2023 have not spoiled the trend? Over the three days of the conference, no panellist hinted as a potential drop of commodity demand caused by a general slowdown of the economies, engineered (but not only) by ever higher interest rates. Granted, possible hiccups have not been ruled out, with their modicum of volatility but by and large the concerns expressed have been more on the supply than on demand side.

So, here after is a quick summary of my take on the main themes discussed.

- Market outlook.

  Are we witnessing the emergence of a supercycle? Probably not in the 1998 sense. No new China is emerging as the world gets more fragmented. However, a few factors underpin higher commodity prices:

  - A wider gap between a tighter supply and a robust demand, mainly because of lack of production investments (Fossil fuels and base and electric metals).

  - The Energy transition is inflationary. Demand will rise per the world GDP growth (much faster for certain critical metals), when substitution by new energy solutions might not be readily available whilst fossil fuel production capabilities dwindle.

  - Higher interest rates and inflation leading investors towards the commodity complex (vs the "financial world").

  - Low stocks in LME metals.

  - Strategic hoarding strategy in agri.

- The Energy Transition.

  - It is getting very real, but can unravel as fast as predicted by economists and wished by the society at large? Probably not. In fact, the risk is that existing production capabilities wither faster than expected. Several panellists mentioned that at the current rate of investment, oil supply is shrinking year on year by 4 to 5 Mio bpd, when demand is still growing by 1 to 1.2mn bpd per annum on average.

  - Underinvestment in fossils seems endemic. One panellist on the mining panel mentioned that to bridge the supply gap not less than a quarter of a trillion-dollar investment was required. Yet, resistance to investment is huge. When the Nimby concept (Not In My BackYard) has applied for a while, we have now entered into the Banana era (Build Absolutely Nothing, Anywhere Near Anything). Investors, already lukewarm to invest in long term project when energy transition clouds the outlook for the long-term demand, do not have any appetite to face reputational challenges. This is equally true for financiers (the FT headline this week castigating a Canadian bank as "top financier for fossil fuel industry" is a case in point[1]).

  - Energy transition is therefore seen as inflationary for many years to come. To add a nail on the coffin, and since carbon is likely to become priced across supply chains, it might get even more expensive. So much for a short-term high inflation environment: economists rather than focussing on current commodity prices and the potential effect on short term price consumer

[1] https://www.ft.com/content/63ebd477-5327-422d-8121-9acc477b138c

prices indices would be advised to also pay attention to the long-term upstream dynamics and these do not vouch for cheaper prices anytime soon.

- China
  - which stimulus? Interesting debate. Hitherto, growth has been led by investments and infrastructure. This time though consumers are fuelling the recovery. A post covid lockdown reaction unleashed by the central government. Whilst the long-term resilience of this push is questionable (consumer confidence could falter, aging population, widening gap between the land locked China and the coastal China…), traders have empirical evidence that the growth engine is – for now – roaring: demand for coffee, sugar is underpinned by the local demand in crowded restaurants; Hogs need rebuilding which is boosting demand for corn and sorghum; air travel (jet fuel demand is strong) and other transport activities have risen above the pre-covid levels. Oil consumption has risen to 16.1mn bpd from 14.5 last November.
  - The effect on commodity prices is therefore positive, but with increased volatility: China's traders are savvy and will try to pick up a bottom whenever they can to build stocks which are currently low (think copper, gas, or grains).
  - What to expect this year? A consensus on this year growth: nothing below 5pct, maybe 6pct. And next year? Below 6pct but not far away…
  - Any black swans? Plenty potentially but mostly stemming from geopolitics rather than the Chinese economy itself.

- Critical metals
  - Whilst the West struggles to build mining champion and dreams about "friend shoring", there is simply not enough investments in these metals, which by the way will still be also sourced in 'not so friendly' countries. Think green aluminium which is predominantly Russian. Or Nickel and Cobalt.
  - Consuming countries are working on taxonomies to identify their critical metals in the frame of the Energy Transition. with interesting differences: Zinc is deemed as critical in Europe, not in the states. Copper is on the EU list, but not on the US one.
  - Copper, the fault line. Prices do not reflect the looming shortage if we stay on the existing transition strategy. Visible stocks are very low (3.5 days of demand!). The last mining projects will start production between 2 to 3 years. Nothing beyond. Demand for refined products is bound to rise with a fast proliferation of copper smelters (in China and Indonesia).
    Price predictions? 12,000$pt this year is highly possible. 15,000$ beyond that.
  - Could the critical metal supply shortage jeopardise the energy transition? The pessimistic view is that it probably will as demand rises exponentially with a

linear supply. Optimists believe the perspective of failure is a Malthusian fallacy[2] thanks to human ingenuity, substitution, technology, recycling etc.

- Oil
  - Worth noting that the summit discussions took place before the Opec+ decision to curtail production by over than 1mn bpd between May and the end of 2023. Before that, traders were cautious after a more aggressive stance at last year summit, a month after the invasion of Ukraine by Russia.
    A phrase to describe the consensus at the summit: prices should get higher they are…. Well, they did!
    Longer term, prices are expected to rise as a combination of lack of investments and steady demand growth before it peaks and this was not anticipated before a few years (some said 2025, most 2030).

  - Opec 1 – Shale boys 0. Opec is firmly back in its role of swing producer, especially with the pragmatic support of Russia. The US tight oil producers have now other priorities than taking advantage of higher prices to boost their production. Their unparallel flexibility to switch off spigots when prices were too slow is no longer a feature. Tight oil producers must repay their debts and to reward their investors. This is not an easy task when interest rates and inflation reached the service industry prices and their resources have started depleting… Even at 85$, private producers are taking rigs off production. The consensus on US tight oil: production should plateau and decline from 5 to 300kbpd.

- Gas
  - This is the market which witnessed the biggest and most unexpected overhaul in just over one year. Europe was importing 40pct of its gas from Russia. This is now down to 10pct (pipelines and LNG). But this switch was not filled up with new supply. Asian demand was killed through high prices at the benefit of Europe. Heaven was clement: winter was mild both in Europe and Asia.

  - This has created a false sense of security reflected by a low price of the TTF (40€ per MGH). Not only at the front end of the curve but more so at the back end. Yet, China’s economy is roaring again, pulling the rest of Asia, alternative supply sources constrained (till 2027), and stocks require replenishment in Europe. So, expect price tensions and volatility for the second part of 2023 with heated competition between TTF and GKM gas buyers.

  - The old debate about gas (a fossil fuel) as a necessary evil may still going on in the wider society. It is no longer within the industry: as the big shift in energy sources fosters electricity, there is no viable alternative to buffer the sharp demand increase in electric power demand. Total reliance upon intermittent sources of renewable supply is not an option. Nuclear energy is constrained and hydrogen not ready.

[2] The belief that humans are deemed to be net consumers of the earth resources.

- Investors agree. Money is flowing to ever more expensive investments in the US to build LNG export terminals. They are backed with long term contracts and European governments which are hesitant to commit over 5 years purchase should better think twice: Asian buyers are less shy, as they are used to sign 15 to 20 years off-take contracts. Besides, these long-term contracts are getting more flexible (more optionalities notably on destinations), so here is the European opportunity to seize.

- Where is going the Russian gas? LNG is till flowing to Europe and Asia. As to pipeline gas, Russia's largest customer will probably be China but this requires a massive infrastructure push towards the East which seems not to have materialised yet.

- Sanctions and unintended consequences
  - Last year's debate on sanction effectiveness is over. Sanctions are effective in the long run. Short term, it all depends on the acceptable balance between pain endured and pain inflicted. The consensus has been that the overwhelming reliance on Russian strategic supply should be curtailed whilst avoiding a surge on energy prices hurting the world economy. The 60$ cap in that respect worked well and whilst European reliance on Russian oil has significantly reduced, the price levels remain very much below the anticipations made at the 2022 summit.

  - Adding to this the self-sanctioning reaction which has been massive. Most banks are simply discarding any Russian business, whether officially sanctioned or not. This has been confirmed both by banks and traders at the summit.

  - Equally, major trading houses have been forthcoming and have all repeated that they were steering well away of any Russian sanctioned business. As to non-sanctioned one, the intermediaries are pragmatically playing the role that is expected of them to adjust supply and demand to keep prices under check. But most do so without little or no support from their banks.

  - However, there were unforeseen consequences of the sanctions.
    - Russian producers willing to sell their oil supported several small and not so small players in granting them a hitherto largely unknown feature in oil trading: supplier credit. They therefore operating with little or no banking support selling Russian oil. At premium? At discount? Abiding by the cap level? The jury is out. Most of these companies, (some are front names of Russian groups) operate from Dubai, which does not seem concerned that hoisting these trades will not help to establish its international credibility as a reliable commodity finance hub.

    - With Russian oil thus financed, a so-called grey market developed involving a large fleet of old vessels, managed, and chartered by third tier players, and displaying skilful management of the vessels'

transponder and transhipment tactics. Many professionals hinted at a heightened environmental risk as this ghost fleet wanders the seas.

- Commodity trading, finance, and banking

  - What a year this has been for commodity trading! Trading houses executives, whether transparently commenting of their respective profits or not, have all made the point that 2022 is not a testimony of a "new normal". It is however one of dislocated markets and extreme volatility. However, so long we are muddling through a demanding energy transition, war, and sanctions, it may well be a "temporary normal" one.

  - The good news is that such level of profits contributed to significantly strengthened the equity base of all large trading houses, some doubling it within less than 5 years. More resilient, large trading houses have also been able to invest heavily in new technologies, logistics and energy production capabilities. Profitably? Time will tell but for now most large trading houses are making "asset bets" on the future. In a well affordable manner. Difficult to argue that they are not engaged in the energy transition push. They are investing with uncertain returns on these futures energies, thanks to record profits out of their traditional fossil fuel trading business.

  - As security supply has become a concern for many governments, commodity traders' image has dramatically improved. Many countries realized that these hitherto cumbersome intermediaries have a key role to play, particularly when markets are getting as dislocated as it has been the case between pandemics and wars. Large trading houses will (rightly so) interject they never encountered problems to get the appropriate support from their large pools of banks. However, the large pool of banks attending the summit, beyond traditional commodity banks, evidences a renewed interest. Several recent deals signed, where public Export credit agencies have granted guaranties to mid-term loans to trading houses against their ability to source strategic supplies for the countries' economies. Such appealing governmental support (and risk mitigation) adds credibility to the industry and contributes to foster non-commodity banks' interest.

  - The recent nickel scandals will probably damp this positive climate for trading houses, but concerns expressed at the summit were mostly limited to pure transactional financing such as repos. Unsurprisingly, banks present confirmed on and off the record that their appetite for smaller traders financing was increasingly limited as big turmoil calls for large established players able to shoulder difficult market conditions with transparency and a strong governance. The recent fraud that affected Trafigura is a case in point: a large loss easily absorbed, rather transparent a communication on a major and embarrassing issue and a prompt managerial reaction. Governance is making a difference.

  - Another evidence that size matters has been given in the financial markets last year. The volatility of gas sending initial and variation margins to new highs, no small players caught by the market would have survived. Yet

Large trading houses made record profits although their liquidity have been significantly tested.

- Whilst large trading houses steered through 2022 with flying colours, some futures markets, have not, and this is probably a major concern going forward. Depth, Liquidity and stocks depletion, fraud risks have shown the limitation of the commodity futures market. The increased use of OTC by traders may pose a significant risk going forward.

To conclude this much too long summary, here after are a few selected quotes and notes.

- On interest rates and commodities (Jeff Curry, Goldman Sachs)
  - we are between the Fed and a hard place.
  - Rule #1 do not fight the fed, rule #2 do not forget rule #1.
- On Trading houses profits. Historically the industry generates a gross margin between 2 and 4 pct So compared to the growth of our revenues, these results are not extraordinary (Jeremy Weir, Trafigura).
- On LME Nickel market. LME nickel contract is not fit for purpose to reflect the global nickel industry when including the battery market. (Jeremy Weir, Trafigura).
- On the oil market.
  - OPEC might cut. Beyond 80? Watch Netanyahu …Untenable situation developing over the Iranian nuclear program as Iran gets closer to become a threshold state (Helima Croft – RBC).
  - The energy mix required to produce what is needed is already too cheap. So, downside is either limited or would be very temporary. Peak demand does not mean lower prices (Pierre Andurand).
  - A major reshuffling is ahead as supply chains have to reinvent themselves. Refining capacity in Europe is largely landlocked creating logistic bottlenecks. From one dependency to another (US)? Many opportunities for trading. (Taghi Taghi-Zada - Socar Trading).
- On gas. The intermittency of renewables means you must have gas baseload (Amreeta Sen, Energy Aspects).
- On Energy Transition.
  - Applying simple solution for complex problems. In fact, we need Complex solutions for complex problems. So, stop telling tales. Otherwise, risk of disenchantment and social unrest (Bill Reed, CCI).

    - To be in renewable, you must understand the power market (M Dunand, Mercuria)

    - Carbon credit trading desks are already profitable activities for Vitol, Trafigura and Mercuria (collective answer on panel).

- On commodity prices. Commodity price present rather than future. They usually do not fully reflect the anticipation of supply demand (G de Dardel, Mercuria).

- On Trading House leadership and discussions with ADNOC. I feel extremely inspired to be here at that time. (T Törnqvist, Gunvor).

  Did we not all?

JF Lambert
18th April 2023