Lambert Commodities

FT Commodities Global Summit 2024 – A take-away

As it has for the past 13 years The Beau-Rivage hotel hosted, the FT 's Commodities Global Summit. Although not all attendants have been also privy to the World Economic Forum in Davos, the Financial Times summit is for the commodity world very much what the WEF is for the global economy: a secluded gathering of most decision makers, be them traders, bankers, hedge funds or – increasingly – Fintechs. Whether in plenary sessions or around drinks and coffees, if not in private meetings, the Beau-Rivage is for two and a half days the place to be, to meet customers, service and finance providers, as well as competitors. Some 670 delegates overall, the majority of which having filled up the ball room and the aisles, whilst the digital audience who followed the debates online was also strong (but lacking the ability to informally network and to enjoy the luxury and unique environment provided by the hotel).
It was a good vintage, and the FT reporters did their utmost to seize the zeitgeist and ensured all relevant if sometimes thorny issues were tackled. In a typical 'FT way': demanding but with grace, humour, and tact.

Geopolitics disclocations, economic sentiment, energy transition and market behaviours provided enough ammunitions for very interesting debates. Whether active players, journalists or educated witnesses, very few would have left Lausanne not acknowledging that these two and half days have been useful, if not enlightening.

The following lines are a modest attempt to crystalize the essence for what has been discussed.

1. Global perspective

Not much has improved in the world over the past few years. In fact, it is quite the opposite. War is still raging in Ukraine, new tensions in the Middle east, shipping lanes are disrupted either by rebels or by climatic events, the global economy is facing a tepid growth, politics whether domestic or global are fractured. All this contributes to expose businesses, making them more susceptible to further unexpected shocks. Enough to keep decision makers awake many nights, especially when the society at large is at the same time expecting a smooth and rapid transition towards cleaner energies.

Yet, surprisingly, the mood in Lausanne did not reflect this. While such worries and challenges were discussed in most panels, nobody sounded alarmist. IT was as if the commodity players had ackowledged that the world was exposed to a new state of play, more dangerous, quite uncertain, and that they had adapted accordingly. After all, goods and raw materials are still flowing around the world, commodity prices are still manageable both on the producing and consumer sides, despite surges of volatility, some high but not lasting, and more importantly causing neither significant nor permanent harm: a new normal, more complicated, but one which is not disrupting the business.

Trading houses are surfing on record profit years, enabling them to strengthen their equity position, build large liquidity buffers, and to safely venture into the new and uncertain territories that the energy transition requires them to explore. Banks, despite an ever tighter regulatory environment have been able to support the key players (at least) in their endeavours. Governments, concerned about supply security have provided an historically unheard support to key trading houses against their pledge to secure key commodity supply chains.

In short, the market has adapted to a fragmented world. That said, the fear of black swans has been expressed in several panels, if only to brush away unbearable risks. The most quoted?

- What if Ukraine were to hit further Russian export infrastructure of oil, liquid gas, and products?
- Middle East situation worsening. Israel doing whatever it takes to prevent Iran from becoming a nuclear power.
- A major climatic incident.

Amid a difficult geopolitical environment and as the world is transitioning away from fossil fuels, one thing is certain: commodity demand will be more difficult to predict. Yet, so long that supply is available, that should be manageable for savvy trading houses...

2. Energy transition

While nobody argues anymore about the transition happening, its pace was much discussed with most if not all panellists acknowledging that there is a growing gap between governments stances and communication around a fast transition on the one hand, and the professionals’ beliefs on the other. For the latter, electrification of the

world economy will necessitate time if only to build the appropriate infrastructure but 'also' to ensure the proper supplies are available to cater for the significant increase it requires in some commodity resources.

Mainly relying on renewable energy to feed electricity is a fallacy as it cannot ensure a baseload to avoid disruptions. Grids are not designed for renewables. This is not to say that renewable energies do not have a bright future. A panellist[1] gave the following, compelling figures: Global demand of energy is 600 exajoules and it is growing at 1pct per annum. Renewables provide 30 exajoules of energy and this is growing at 20pct a year. This means that today, renewables are entirely feeding the demand growth (6 exajoules a year).

However, when the whole market for new cars (80 million per year) turns electric we will need every year 8 million tons cathode's active material, 100 times more rare earth components, PGMs etc in each EV than in combustion engines vehicles. This is hardly compatible with the current supply projections.

The substitution concept is increasingly challenged, therefore. As professionals have been suggesting – and in Lausanne never more openly than this year: to succeed, energy transition will need to embrace the concept of complementarity. That complementarity occurring between fossil fuels (coal to gas for instance), between fossil fuels and renewables (upgrading a coal fired power plant with a share of wind energy as a backup) and amongst new energy solutions (using CCS to produce hydrogen for instance). That will certainly make commodity demand much more difficult to predict (where, what and how much?). The consensus in Lausanne was that oil, gas, nuclear energy and even coal in certain regions (India, Asia) will remain part of the equation for several years if not decades.

This also means that sourcing of critical metals to the transition will remain a pure geopolitical play with a massive dependency on China and this notwithstanding the uncertainty around battery technology. The faster the transition the stronger our reliance on China's rare earth supply.

Last but not least, copper demand looks like a runaway train gathering momentum when on the supply side, grades are decreasing (by 30pct in the last 15 years) and new mines are too few. Last year globally, mining exploration mobilised 14bn$, half of it for gold, (not copper!). 10 years ago, the world was spending 20bn$ per annum on mining exploration and the thirst for copper will not be quenched by secondary supply.

Energy transition will not only take more time but will be inflationary (even if not considering the necessity of a global carbon price). As Bill Reed from CCI said: when are governments going to start sharing this truth with their public opinions?

3. Artificial Intelligence and big data

A new topic this year, but one which should remain high on the market priority list for many years to come, AI emerged probably as the biggest 'known unknown' and this for several reasons.

[1] Kingsmill Bond- Energy Strategic Insights

First and as has bluntly expressed Sebastian Barrack from Citadel, hedge funds have a head start in using data more efficiently. Citadel has indeed been famous for its massive investment in technology and the ability to anticipate demand and meteorology among other topics. This allowed them, as Marco Dunand from Mercuria admitted, to take more aggressive yet educated risks than physical traders. What is at stake is not simply to better harness the available data, but also what Barrack called the elusive data (info not readily usable as not in clean format) and more importantly, the data which does not exist yet, predicting for instance future physical contracts not finalised yet…

This poses a challenge to large physical traders, and all the CEO's present on stage both acknowledge this forming gap around big data analysis and confirmed that their firms had been investing significantly in AI technology to support trading decisions more effectively. Incidentally this will further the already large knowledge gap that smaller traders face vs their big competitors reinforcing the self-fulfilling prophecy of commodity trading inexorably moving in the hands of a few very large players.

AI is also contributing to the overhaul of trading middle and back office functions to make them more effective, resilient, and cheaper. However beyond the changes AI will bring in trading whether in front or in support functions, a massive challenge lies with the power requirements to run an AI based economy. Richard Holtum from Trafigura said that running a search on ChatGPT required 9 times more power than a Google search. "by the end of the decade, AI data centres could consume as much as 20% to 25% of U.S. power requirements" according to ARM's CEO[2]. That could boost the copper demand (already in deficit) by 1MT according to Saad Rahim from Trafigura and require gas and nuclear industry to warrant the baseload power sources to electricity grid.

As AI technology gathers momentum across businesses and geographies what will be the effect to energy transition? It might void most of the existing goals and aspirations and necessitate a brand-new energy mix. Transformation versus transition? Now this is an existing challenge and a topic for many FT summits to come.

4. China

China is the second largest economy after the US. When it comes to measuring its impact on commodity markets, however, China is by far the first economy in the world. A 4 to 5pct GDP growth this year is therefore very good news. Physical traders pointed that they have ample empirical evidence that the middle kingdom economy is indeed still strong and this despite the poor state of its real estate sector. Demand for oil should grow by 600 to 700kb this year; demand for copper, for aluminium and gas is also and evidenced by raw materials import balances.

The relationship with the US has been extensively discussed. Martin Wolfe from the FT showed that the quest for alternative partners in supply chains where China is dominant is more realistically focussed on identifying a "+1" partner than a substitute to China. He stressed that the level of dialogue between the US' and China's administrations has been better than meets the eyes with a sort of non-economic

[2] In WSJ 9/04/24

aggression pact (this is “a relationship forever”). Comforting for sure, but what if Trump is elected in November?

For now, if the energy transition is happening somewhere, this is in China which is pivoting fast towards green energies. EV’s represent 50pct of the new vehicles sales and the investments made to upgrade the manufacturing sector are massive (solar, wind, EVs). One consequence of this is that electrification of the economy could leapfrog in China and fossil fuel demand could peak earlier than expected there, at the very least in the industrial sector.

5. Russia and Sanctions

The world – including Russia – has grown accustomed to sanctions. As sanctions proliferated (Iran, Venezuela, Russia) the so called “dark fleet” (referring to vessels turning there positioning transponder off) which was non-existent 10 years ago is now strong of 600 to 700 vessels. This represents short of 10pct of the total deep sea ocean fleet. Shipping specialists insisted on a massive risk of sea pollution as maintenance and reckless navigation could result in collisions.

Much debated was the effectiveness of the said sanctions on Russia. After all the country still exports its oil, the West is still buying Russian oil products after transformation in Indian and Chinese refineries, and Russian LNG is still directly purchased by European countries.

Were sanctions designed to choke Russian commodity exports? Not quite commented most specialists. There were meant to make Russia suffer economically, without creating a supply shock for the consumers worldwide. In other words, sanctions have been as effective as we could afford, and Russia has been quite efficient to adapt. Within two years Russia spent some 9bn$ purchasing tankers largely contributing to the recent development of the dark fleet.

So, what is next? Should we expect a clampdown on the dark fleet? Why are we not targeting the ‘bad’ traders which, out of Dubai notably are helping Russia to circumvent the price cap? A question that would have certainly been asked to the representative of Dubai, if he had not cancelled his participation to the summit at the last minute… For now, it boils down to OFAC to go further than sanctioning 40 tankers (15pct. of the Russian shadow fleet). Measures are identified. Question is how far are we willing to go? For now, not much farther, it seems. Recent sanctions in the LME were the first attempt to hit Russian metals but their high quality is badly needed by the European industry, so it is for now unlikely that significantly tougher measures are implemented.

While sanctions are here to stay, the participants of the conference left rather convinced that the game of chicken is not for now going to escalate much further and ‘bad’ traders will keep enjoying a great business stream out of the south cost of the Arabian gulf…

6. Price outlook

Not much dissensus here either. First the fundamentals. On the energy front, oil and gas will remain strategic for the foreseeable future. This helped explaining why the

trading house representatives were somehow comfortable despite fragile and unpredictable geopolitical context. Oil is their bread and butter and their strong interest in power fostered by the electrification of the world economy is aligned with their ability to trade LNG and natural gas. Outlook for the year is much depending upon China. Regarding oil demand, China represents 45 pct of the expected overall market growth for this year, i.e. 600kb to 700kb. Achievable? As stated, participants were reasonably optimistic about China.

The supply side has been so far well managed by Opec+ (in fact Saudi) and the current price band (between 80 to 95$bl) is seen as a good compromise for both producers and consuming countries, probably with some volatility and spikes reflecting the likely geopolitical tensions.

Gas should remain low and new production is coming up to market in 2 year-time, but the complementarity concept should only grow gas consumption significantly in the next decade with the US acting as the world swing producer.

On the metal side, uncertainty surrounds the battery metals (Indonesian outright supremacy in nickel production, glut in lithium and cobalt and technical uncertainty & competition surrounding EV batteries – NMC and LFP). The consensus remained bullish on copper (naturally), aluminium – a potential alternative to copper and zinc (for galvanisation).

7. Financing

Not much to say about financing. It has been more expensive obviously as interest rates are no longer negative. Banks have provided sustained support to large trading houses where needed, with a caveat around regulation, compliance and sanctions.

Liquidity management however has been flagged by several trading house as an function that has been significantly sophisticated and optimized as the cost of funds arose. Prioritisation of cash allocation to business has become more refined than at the bygone time of cheaper money.

Inventory management has been flagged as more constrained. One could think of another explanation beyond a tighter liquidity management: backwarded markets…

Some clouds on the horizon for banks: Basel IV regulations have been hailed at (even) less friendly to commodity and structured finance. This probably means that so called the number of incubator banks – banks financing smaller commodity traders – will not expend and may even shrink. The flight to quality will remain the strategic axis of large commodity banks. As most of their customers have built strong equity bases over the past 5 years, banks have been able to provide them with more financial support for a decent return on capital. However, it also means that large trading house will have to spend more of their liquidity to support their own strategic supply chains as banks are unlikely to do so on their behalf for the regulatory constraints keep making this type of lending unattractive.

When banks list their worries interestingly, they are rather inward looking: operational risk, compliance and Basel regulation. Well business development does

seem to be on the agenda. Is keeping their existing customer base already good news? Probably… Trading houses are so warned.

8. Finally, some quotes

- “In today’s world commodity sourcing is by and large a geopolitical play” (M Wurmser – Norge Mining)

- On ESG
  - “ESG increases demand for commodities while at the same time constrains supply” (Rohitesh Dhawan – ICMM)
  - “ESG matters but security matters more” (M Wurmser – Norge Mining)
- Torbjörn Tornqvist – Gunvor to Tom Wilson from the FT.
  - “How much cash you have available for investment?” Pause. “A lot.”
  - On frauds “you cannot change the past, but certainly can change the future”
- Jeremy Weir
  - “GenZ do want to work in a trading company”
  - “Last time I was asked to resign. This time I should retire?”
  - “Managing such an organisation? at times you are very lonely because you have often to make the difficult decisions”

- Marco Dunand – Mercuria
  - “We want to get physical”
  - “if you do not move the so-called stuff, the world does not work”

- On energy transition
  - “we failed to invest in horse processing in 1900. Have price gone up? Gee! There came a new game in town. It was called cars” (Kingsmill Bond – RMI)
  - “Green transition is never going to happen” (Martin Wolfe)
  - “ET not happening? Wake-up It is happening and it is happening in China” (Kingsmill Bond – RMI)
  - Energy transition has and will happen. But over the past 2 years a bit more realism came into the discussion and a bit less emotionalism. So people have now acknowledged that energy transition will happen in different stage and in different ways in different parts of the world. (Roland Rechtsteiner – McKinsey)
  - “Regulations surrounding the financing of the Energy transition is protecting the world against green washing. But what it is not protecting against is green hushing whereby lenders are doing the absolute minimum to satisfy regulatory demands” (Rebecca Harding – Trade Economist)

- “They are two states of being: in a recession and when recession is coming” (Saad Rahim – Trafigura)

- On Iran. “will a Trump administration escalates sanctions against Iran?” – “Initially there may be strong rhetoric but beyond that, Donald Trump does not want to see the price of oil escalates so if this is required it is expected that

calls are placed with the Saudi's first to ensure a significant flow of barrels is available." (Helima Croft – RBC)

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