Opinion: Commodities in another year of complexity

Jean-François Lambert, Founder and Managing Partner at Lambert Commodities, discusses the complexities and moving parts governing commodity prices. A return to the 'old normal' is not likely.

Last year this review opened on a quote on complexity[1]. The same quote could be repeated this year and as things go, probably for several years ahead. A permanent mayhem? Not quite, hopefully. Yet, intuition tells us that what we are going through is more than a string of crises. Deep and lasting changes are reshaping our world in many of its facets: geopolitics, economics, societies, climate, among other things, to the extent that it could be permanently altered. Gramsci, the Italian philosopher, perfectly described the zeitgeist of the first part of the 20th century and his take remains very topical nowadays. "The old world is dying; the new world is yet to be borne and, in that twilight, grow monsters"[2]. So, complexity? Definitely: to decipher the profound changes taking place. A return to the 'old' normality seems ever more doubtful.

Several moving parts are shaking our world, its organisation, balance, affecting economic and social behaviours.

Multiple moving parts

The most striking one is the deteriorating

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geopolitical environment. Samuel Huntington theorised 30 years ago[3] a clash of civilisation for which he was much criticised. However, the current fragmentation of the world seems to give credit to the concept that strong underlying currents are roaring. Incidentally, Ukraine was construed by the author as a potential fault line. Old Europe is struggling to adapt to a world where the US and China (together over 43% of the world GDP[4]), whose economies are de facto complementary, have emerged as arch rivals. Decoupling seems to be their mutual strategy, however unrealistic.

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At the same time, a new war has started. This one is led by Central Banks: the 'war against inflation'. In little more than a year, interest rates which had remained very low to negative for over a decade have risen to

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around 5.4%[6]. This, compounded with geopolitical tensions has triggered a slowdown of the world economy[7], potentially affecting lower income countries badly.

The climate backdrop is not offering any comfort. Global warming is not abating and the 1.5°C target[8] looks increasingly optimistic. Hurricanes are becoming a new reality in many parts of temperate regions. El Niño and la Niña are now well-known phenomena bringing ever more frequent turbulences.

The last moving part, this one of our own volition, is energy transition. Transition though may be the optimistic way to describe what is underway. The decision to get away from fossil fuels will eventually reshape most if not all industrial processes on the planet and therefore affect most supply chains. Expect a deep and convoluted process. Hence, 'transformation' probably defines more accurately what is at stake.

All these parts moving simultaneously are shaking our confidence, as investors, producers, consumers, or citizens. As tectonic plates do to the earth, they foster fear, doubts and at the very least uncertainty about bearings and trends. Markets reflected this when for instance, an upside surprise in US economic indicators triggered a sell-off of the S&P 500, for fear of a potential reaction by the Fed on rates. Or when oil prices did not climb beyond $90 per barrel as if the turmoil in the Middle East were not a harbinger of massive tensions, a threat gold prices did react upon as they breached the $2000 per ounce glass ceiling.

Non-linear commodity prices

Indeed, commodities like every other asset class have been affected. Prices have not followed a linear path so far this year. Their behaviour cannot be simplistically explained by the traditional inverted correlation with the dollar. More so than in many years, they have been juggled around by the vagaries of the moving parts described above.

The energy complex, for instance, is under the spell of three currents[9]:

1) Geopolitics as Europe endeavours to diminish its dependency on Russian supply, much to the delight of China and India. Saudi Arabia, whose special relationship with the US is waning, struck an alliance with Russia and together with its Opec sidekicks (including Iran), has tightened the output of oil just enough to maintain prices at a 80$ threshold.
2) Economics as on the one hand, overall demand is still growing well despite the attempt of central banks to slow down activity to stem inflation, but on the other, uncertainty on growth prevails.
3) Climate as winters have been mild in the northern hemisphere while Asian economies have slowed. Hence, there has been little competition with Asia for LNG so European reserves have been swiftly and cheaply replenished while gas prices are trading much lower than was anticipated a year ago.

Agri commodities are either affected by geopolitics with grains and fertilisers put under the cosh by the Russian Ukrainian war or climatic disruptions (such as El Niño) in several parts of the world affecting staples supply such as rice. Hence worries in poorer countries have been about affordable food supply. Add to this multiple local protectionist measures to either protect local production or prioritise local consumption limiting export capabilities, and all ingredients are there to ensure price volatility.

Metals prices have been under pressure. Metals demand is very dependent upon the economic backdrop and this year has not provided much comfort. Concerns have been rising about the Chinese economy (and its real estate sector) and the ability or willingness of China's central government to do 'whatever it takes' to boost it. Even the so-called electric metals, on which the world relies to achieve the energy transition under way – the likes of copper, nickel, cobalt, lithium, etc. – are underperformers so far in 2023 as there is no evidence of robust economic activity anywhere. The mid-term outlook is not concerning the market now. Had it been, electric metals and particularly copper would have traded much higher: existing or even planned production capabilities are limited compared to the potential demand stemming from the transportation sector as electric vehicles' number rises.

Looking ahead

What can be expected in this vortex? While some reasonable assumptions can be made on a mid to long term outlook, the immediate environment remains quite uncertain.

- The energy transformation of the world productive apparatus is likely to have much deeper and long-lasting consequences than is anticipated today. We could be at the eve of a period similar to what the world witnessed in the 19th century with the industrial revolution. For now, though, the energy transition is likely to be quite inflationary as it triggers a massive destabilisation of an hitherto efficient productive system.
- Meanwhile, the polarisation of the world will make trade much more complex, muddling through protectionism, sanctions, alliances with a tense political agenda taking over from the sheer economic dynamics that were in play during the grand globalisation era.
- We have all become environmentalists and while the world has probably entered into a long phase of active warming, it means that our economic agenda will have to keep adapting and aligning with shifting social priorities.

From a pure commodity standpoint, this will likely translate into a succession of multiple supply and demand shocks. Physical trade will remain under pressure. Companies and countries will be searching for new procurement strategies as diversification to avoid dependency in a shaken geopolitical environment is now a clear strategic priority. Does all this mean that commodity prices are bound to climb? With so many parameters behaving hectically, predictions are foolish at this juncture. One thing is likely though: high volatility, and this may not be good news for governments, central bankers or consumers.

Commodities are by nature strategic: societies cannot do without them. As sourcing becomes more challenging, when supply chain managers are guided by different priorities, the role of trading houses will become ever more crucial. The role of trading houses will become ever more crucial to absorb or limit risks while ensuring the flow of the indispensable is never interrupted, come rain, shine, transition, revolutions or wars. ■

Notes

1 "This is the most complex, disparate and cross-cutting set of challenges that I can remember in the 40 years that I have been paying attention to such things." Larry Summers former US Secretary, Oct 2022.
2 Antonio Gramsci, 1930 Prison Lettres.
3 Samuel P Huntingtonxc The Clash of Civilizations, Foreign Affairs Summer 1993.
4 World GDP 2022: $100.6Tn, US GDP $25.5Tn, China $18Tn sources World Bank.
5 "It is the economy, stupid!" James Carville, advisor to Bill Clinton as a motto for the 1992 presidential campaign.
6 Aggregated leading interest rate for 49 countries, source Rexecode Sep 2023.
7 IMF World Economic Outlook Oct 2023 projects the global economy will grow 3pct this year, 2.9 in 2024 vs 3.5% in 2022.
8 Paris Climate agreement pledged a 1.5 degree Celsius cap on rising temperatures by 2100.
9 A fourth current should impact energy price, i.e. the Energy Transition; however the market prices have not really reflected this so far this year.

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