The FT Commodities Global Summit 2019

For the commodity world, spring does not begin on the 21st of March. It begins with the Financial Times Commodity Global Summit, at the Beau-Rivage palace, on the shores of the Lake Geneva in Lausanne. For two days, the crowd in the hotel is not made up of tourists, but of commodity traders, miners and financiers. The focus is not about excursions on the lake but is firmly set on the natural resources industry, present and future, and on commodity markets. Nowhere else can we meet most of the decision makers, get a feel about their view of the world, their strategy and ambitions, but also their worries and doubts. In the 8th edition of the summit, The FT contributors did a pristine job in drilling the industry leaders and ensuring the audience got a comprehensive perspective on the commodity world at its close.

'Natural Resources in Transition' was this year's main theme, one which infers that there are forces in motion, reshaping and challenging long-held assumptions, about globalisation, geopolitics, technology and the sheer way business is conducted.

A thorough account of the debates has been provided in the press and notably the FT, but for those in need of a quick summary, here after are my take-aways.

- **The economic backdrop**. Most speakers share a mildly positive view of the world. Whilst signs of slowing down are numerous and momentum falling, world growth is still anticipated to remain above 3pct this year, with the two leading economies, US and China still doing rather well. A recession in the US? Possible, but certainly

not in 2019. China slowing down? Yes, but with a 6 to 6.5pct growth rate, demand for commodities is bound to remain healthy.

- **The trade war**. Obviously, a concern for the industry, but the general stance amid speakers was that both parties were in need of an agreement, enough to foster a smoother business environment than last year. However, and if this probably makes the imposition of new tariffs unlikely, nobody showed any confidence about the lifting of the existing trade tariffs. The rivalry between US and China will remain strong, notably as China does not assuage the concerns re intellectual property and technology abuse. So, we should expect a long, procrastinated fight with China, and this not only from the Trump administration: concern about China under Mr Xi's authoritarian grip is widespread, from democrats to republicans, from the US to Europe.

- **Geopolitics**. Many clouds in the sky but no rain as to yet. Globalisation is no longer seen as good news, but as a necessary evil. Calls for protectionism are manifold, and voices of frustrated populations are growing amongst democracies. Whilst most participants shared concerns, they were quick to say that so far there was no life-threatening crisis for the business. Whether short term players – traders – or long-term investors – miners – no one said that their strategy was to be altered. It is all about adapting and fine-tuning in a more hazardous environment *potentially*. One concern though lies about the sanctions against Iran, or rather about the likelihood of the renewal or lift-up of the current exceptions allowing several countries to carry-on buying oil from Tehran. If the latter was to happen, it would create significant disruptions in the oil market.

- **China**. A clear consensus emerged in the summit. Whilst China's momentum has indeed suffered, we have probably lived through the worst and stimuli measures taken centrally are bearing fruits. Therefore, a 6 to 6.5pct growth this year is achievable. Although the absolute level of 6 can be challenged as China's statistics are to be taken with more than a modicum of salt, the economy is still growing at an emerging market pace. For how long? Few would bet the trend holds more than a few years, but for now, it is undisputed. Asked about China, the CFO of Rio Tinto, just coming back from the Middle Kingdom, said he had been positively surprised about the economic climate there. Encouraging indeed, but would an iron ore miner say otherwise?

- **Commodity trading**. Overall a tough market across commodities et especially in energy and agri. As the CFO of Trafigura put it 'the days of easy margins are over'. Oliver Wyman in its latest report opportunistically released at the eve of the summit, stated that commodity trading margins could fall to 30bn$ by 2025. The decline has started in 2015 when margins plateaued at 44bn$, according the consulting firm. Estimates for 2018 are at 34bn$. No trader argued that the margins would climb back. Outbursts of volatility are no longer enough to fight the trend. Price discovery has improved and is no longer the exclusivity of large commodity houses. Customers, suppliers and techfirms share the available

information, which itself is getting more accurate and widespread. According to CFTC, 2/3 of CME crude oil contracts, 54pct of precious metals contracts and 50pct of soybean contracts and are now automated. Quants sit in all commodity trading floors.
Against this backdrop, robust data analytics, strict cost management and process optimisation are no longer nice to have. They have become critical and this explains why blockchains and digitalization of paper process are being actively explored. Alliances are formed to build platforms and industry wide solutions, such as the one linking five ABCDs in the agri commodities – the 5th one being Cofco, or Vakt for oil trading. Commodity trading 2.0 is on its way. How many players will have the scale, the critical mass and financial means to generate a proper return in highly transparent, efficient market places? No one knows but expect consolidation along the way.

- **Oil trading**. The theme of this year's global summit Natural resources in transition shaped the discussions: shale oil – no longer a blip but here to last , IMO rules on heavy fuel, peak oil – Vitol's new CEO stated a few weeks ago that oil demand would grow for 15 years but is to decline thereafter… and yet (would this come as a surprise?) short term concerns mattered more to traders than the long view: can oil price rise above current level? – probably not. What disruption might we face if US were to ban exceptions to the sanctions against Iran? How will the latest POTUS' tweet influence the market?...
  Navigating through current market conditions is not easy: margins are ever slimmer. To sustain profits, it is necessary to trade significantly more volumes than before (Trafigura's revenues in 2018 rose from 136bn$ to 180bn$ and the trading house is no exception). Where to find added value in this context?
  Responses vary amongst trading houses: some like Mercuria would focus on structuring solutions and use trade flow to foster financial engineering; some like Trafigura would invest on logistics in new exporting markets such as the US, some like Vitol believe they have the capacity to keep ahead of the crowd by doing more of the same, just better, to remain in the top 3 biggest players. Others like Gunvor, will muddle through after a difficult and painful year in 2018.
  However, oil trading is no longer the prerogative of independent trading houses: already BP, Shell and Total are huge and very profitable contenders in trading. But new trading players are entering the market place: Exxon is recruiting its traders' team; Rosneft has trading activities in Geneva and now Singapore. In the Middle East, Adnoc boosted its trading activities in 2018 and now, Aramco recently stated its ambitions to trade non-Saudi origins. Are the independent traders worried? Not at all, they all sang in chorus: the more the merrier. The National Oil Companies movement toward trading is a logical move as they want to extract more value, out of the system. "They are not to become swashbuckling traders". Maybe. Yet, "Going forward the world is going to be Saudi Aramco's playground" said Aramco CEO in February. The market place looks rather crowded and margins do not offer much breathing space to face likely heavier competition, going forward.

- **Agri trading**. Whilst Cofco's CEO endeavoured to display the Chinese ambition in agri trading (albeit with more "collaboration than competition" and a lot of "support to the supply chain" along the way), the other large agri traders present (A, D and G – we missed B for Bunge and C for Cargill this year…) shared a consensus over how markets were too fragmented, why critical mass was ever more important amid permanently difficult market conditions, and about the bleak future for small players in the field. In retrospect, one might want to watch the panel again, aware as we are now thanks to the FT after the summit, that discreet contacts were held by the former CEO of Dreyfus (in the audience…) with Glencore (represented on the panel by the CEO of the Agriculture business) with a view to explore potential collaboration... This may have explained both the relative discretion of the successor of the former (on stage), some measure of arrogance by the latter and the interested yet very measured stance of the head of origination, trading and ops of ADM.
  Further consolidation should be expected, anyway. The geopolitical environment makes this more complicated as the range of possibilities has shrunk (a Chinese group is no longer in a position to acquire a trading house listed in the US), but the emerging giant – the 'other C'- has both strengths (the Chinese shorts) and shortcomings (the longs, especially in non US origins). It would therefore be surprising if Cofco was not involved in further partnerships in the near future.

- **Mining**. The clear message miners conveyed was that they are doing the right thing. The right thing vis à vis their shareholders, serving them attractive dividends: 40pct pay-out ratio at Anglo-American; Rio Tinto paid almost 20bn$t to their shareholders over the past three years, accordingly to LEX. The right thing with regard to their responsibility to the environment after the terrible accident in Brazil (lets share best practices and technology so tail dam accident become a thing of the past, proposed Anglo-American's CEO). They also claimed they were doing the right thing vis à vis our future, i.e. investing in new capacities. This is the message which was the least convincing. No panellist claimed that they were significantly investing in new mines. Rio Tinto CFO pledged that they will grow their production of copper by 2 pct. (in terms of copper equivalent tons) for the next 5 years. When factoring a 3 to 5 pct., growth of metal demand worldwide every year, then the rather logical conclusion is that the mining industry is in the process of creating scarcity in the next 3 to 4 years. And of course, this is excellent for metal prices. Glencore has already said that they would not invest in new capacities in coal. Unless – and this is unlikely- China collapses, a long metal position in the form of mining shares looks to be an attractive bet.

- **Transition**. Natural resources in transition was the main theme of the summit. There is considerable pressure on decision makers in the industry to hasten the pace for a decarbonated economy. The stance of most leaders on stage reflected this. Traders acknowledging that they are part of the transition process – how to do this is altogether a different issue: shunning coal? Not so fast: demand for coal will continue to increase in Asia for at least the next 15 years. Moving into renewables? Maybe but what is there to trade? As Vitol's CFO put it, 80 of the

business will be more of the same, and maybe 20 pct. will cater for new sources. A reasonable statement, if not a bit optimistic, for now… What traders are keen to demonstrate however, is that they have embraced a robust code of conduct in the way business is carried and that they are becoming responsible corporate citizens. Miners took two routes to acknowledge they were taking the transition seriously. The technological one whereby, less energy, less water will be used to produce cleaner outputs (Anglo-American was particularly convincing). The other road goes by a reshuffling of miners' portfolio or strategy and chiefly around coal. Rio exiting coal production, Glencore capping its investment in the most hated metal in town. Anglo-American indicated that they were working on 'a pathway' to retire or dispose of thermal coal assets.

Let's not underestimate the importance for mining companies to convincingly demonstrate the shift in their strategy: investors are getting very nervous to support the industry, particularly after the disaster in Brazil whereby Vale's tailing facilities broke lose killing hundreds of people. Beyond this terrible accident, investors are indeed under pressure to be more proactive in supporting the natural resources transition: Norway's oil fund which was fed by the oil benefits has started to pull investments from some oil and gas producers. A very interesting panel in Lausanne confronted investors, pro and anti-fossil fuels. Whilst the formers acknowledged that transition needed to be engineered, they pledged (rightfully so) that the world still was relying on fossil fuels and therefore money still needed to be invested into their production. The latter on the contrary, made a clear point that investors had the responsibility to hasten the transition process and should not pump money anymore into fossil energy. Pondering this, one cannot but shive at the thought that in not too distant a future, neither banks nor investors will support an industry on which the world will continue to rely for the most part of our life and those of our children…

- **LNG**. Gas deserves a special mention. It is widely viewed as a cleaner alternative to both coal and oil. Asia has been quick to take advantage of the supply of LNG provided by a growing export flow of shale gas from the US, new production capabilities in Australia and also further investments in Qatar. Aside to the traditional take-or-pay long term contracts, a spot market has emerged. Offtakers of the long-term contracts have successfully renegotiated their commitments to allow re-exports and more flexibility in shipment destinations. Major trading houses have all built LNG trading desks. LNG has become a commodity. The problem is that there are suddenly too many fairies around the cradle: besides producers and traditional traders, end-users and notably the Japanese have also built trading capabilities. To make things worse, the winter in Asia has been mild and here we are. Supply is far exceeding demand and prices have tumbled, with little hope for a quick rebound. So, and whilst no one challenge the long term attractivity of LNG, it is for now a difficult trade, one which is not providing the expected silver lining to boost the energy trading profitability. Traders at the summit hinted at the possibility of some production being shut down to rebalance the market, but no one would bet on this.

- **EV**. A large part of the excitement around the great substitution of oil by electricity in transportation, as reflected in battery metal prices has gone. Not that this is not going to happen, it will, said all panellists. Albeit in time. Indeed, in China, who is obviously the main driver of the EV transition, car sales dropped by 17pct in the first two months of the year, but EV car sales jumped by 70 pct. However, China just cut its subsidies to EV significantly. This led to an interesting comment by the VP of Pala investments and the CEO of Livent Corp that we have moved away from a policy driven growth to a consumer demand growth. This means that the changes will be less abrupt and as stressed by Platt's, this will probably give more visibility to market players as demand growth will become more foreseeable. Coming back to battery metals, one comment was made that the response on the supply side had been much faster than expected when at the same time an immediate surge in demand has not materialised in the same magnitude. In the DRC, the cobalt prices rise in 2017 and 2018 led to new artisanal production and stocks jumped from 10,000 tons to 25,000 tons, enough to make 3.5 million EV, said the CEO of Eurasia Resources Group. A 100 new projects to produce lithium have been launched since prices doubled in 2017, as demand is foreseen to grow 20 pct per year for the next 10 years. So, whilst long term prospects are strong the market is for now over supplied. Exception to this is copper which will be used in EV and recharging stations, where little new investments have been made.
  Palladium and platinum also attracted comments. The CEO of Anglo-American indicated that the recent bubble in palladium could continue for a while but that as technology evolved and prices differential remains high, platinum will increasingly be used as a substitute. Possibly interesting arbitrage there.

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07th April, 2019