

# Le dernier mot

Jean-François Lambert gets out his crystal ball and finds that clues to what might happen in 2016 lie in OPEC, China and the dollar – among other triggers



**Y**ou could say that 2015 was a challenging year in many ways for the commodity sector.

However tough the environment is, and however uncertain times appear, the instinct of business people is, whether they are traders, producers, bankers, is that the game is still on and business continues. And we all know that if a smart view on the markets has not been taken with a reasonably strong pipeline built up, the second half of 2016 might be one where attention moves to cost management. We have been there before.

## Low points

On 17 December 2015, the Thomson Reuters CRB index of commodities touched a 13-year low, lower than we had seen during the global financial crisis years. One could argue that the years of world growth in excess of 5% are behind us. We are back in a more boring era of slow growth where a 3% for 2016 would be very good news.

Inflation is no longer the worry – inflation of 2% is now seen as the sweet spot by savvy central bankers, and we are not anywhere near there. This is our “new normal” and we need to just get used to it.

## Three directions and two wildcards

In such an environment, commodity prices are difficult to predict. If any, our best guess would be bearish... However, when do commodity markets behave as expected? History has taught us to be cautious with the obvious: “the expected never happens”, said John Maynard Keynes, “it is the unexpected always”.

So at the cusp of 2016, what should we be keeping an eye on to better anticipate market moves? I would suggest three directions and two wild cards.

## Direction 1: OPEC

In December 2015, this venerable organisation, entangled amid heavily loaded opposed vested interest, decided...not to decide anything.

The market got the (non) message and kept testing ever-lower levels. This offers little hope for a sharp rebound in 2016. However, Mr Naimi might surprise us all. A US\$20/bbl price would certainly not make Saudi life any better amid a complex power struggle in the region and more challenging diplomatic relations between the Kingdom and its traditional allies in the aftermath of terrorists attacks in the EU and the US. Anyway, I believe that one can count on markets to build the necessary pressure until a low has been found.

## Direction 2: China

China’s economy landing, if not hard yet, is not soft anymore. The 7% magical threshold is no more, and transition to a semi-developed juggernaut has accelerated. Furthermore, the slow growth of the developed world has not helped with fostering China’s exports.

Local consumption remains subdued and, as Rollo Tomasi observes on page 28, China has been exporting its surplus commodities to the world in the form of steel and aluminium.

Yet China should not be discounted. According to *The Economist*, it contributes to 40% of world GDP growth, more than twice the US share. Thought should also be given to Middle Earth’s ability to foster its economy. Today’s 17% reserve requirement represents, according to HSBC research, around RMB22trn of untapped liquidity that could be released at zero cost to boost lending. This is a missed opportunity, so come on Mr Xi, let’s see more economic stimulus, and pragmatism.

## Direction 3: The US dollar

The inverted relationship between US dollar strength and commodity prices is well documented and it is no surprise that the fall of commodity prices in 2014 and 2015 was accompanied by an ever-stronger US\$. The conventional wisdom is that a stronger interest rate which is now the Fed’s strategy should further boost the US\$ against all currencies. The question, though, is how far the US\$ could go without seriously harming the US exporters? We should not discard the possibility of a more stable US\$ in 2016, fuelled by a lightweight touch by the Fed and a more dynamic eurozone.

## Wildcards

- The weather phenomenon El Niño gets its name for a reason: the impact starts to be actually felt around Christmas and, if the specialists are right, we could witness a very strong manifestation of El Niño this year, which would affect major agri-commodities, but also mining through droughts and rains (see also [www.tfreview.com/node/12009](http://www.tfreview.com/node/12009) for more on this).
- As for the second wildcard, you only have to remember that the Russia/Ukraine crisis blew up very suddenly. And another geopolitical crisis is never far away in today’s world of renewed tensions in the South China sea, in the Middle East and Eastern Europe.

So, 2016 could surprise us all – for the very best or worst reasons. **TFR**

Jean-François Lambert is a consultant on commodity finance. He is the former global head of commodity and structured trade finance at HSBC and can be contacted at [jflccf@yahoo.com](mailto:jflccf@yahoo.com)