FT Commodities Global Summit

Metals trade proves more attractive than oil in trend reversal

Role swap will be a key talking point at this week's FT Commodities Global Summit

Following years of under-investment by mining companies, supply constraints are becoming evident across many metals markets © Bloomberg

Neil Hume and David Sheppard MARCH 20, 2018

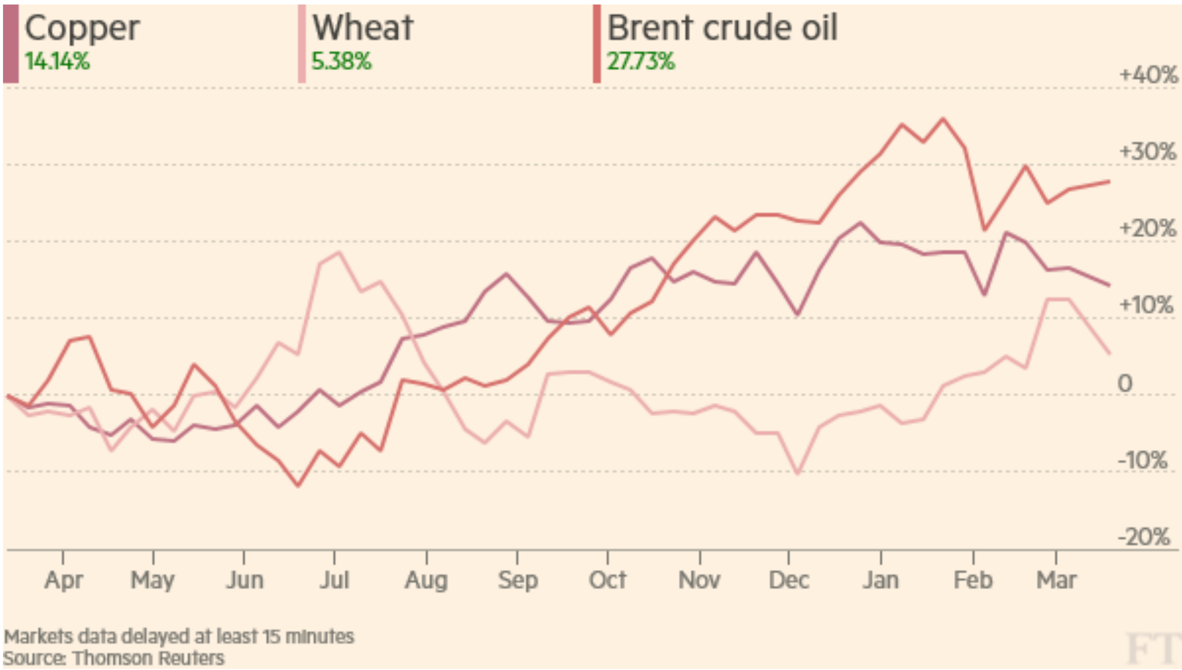
For the first time in years, buying and selling metals is proving more attractive for the world's top commodity traders than shifting barrels of oil — a dramatic reversal of the trend for much of this decade.

Strong global growth and supply constraints following years of under-investment by cash-strapped mining companies have created lucrative arbitrage opportunities for big metal traders as consumers have rushed to lock in supples of aluminium, copper, zinc and other materials.

While oil prices have also recovered, this has made it more difficult to make money from buying cheap barrels of crude, storing them and selling them later at a higher price. These so-called cash and carry trades helped the industry deliver bumper profits during the two-and-a-half-year oil market downturn that started in 2014.

"Metals are the poster child of the industry at the moment," said one senior commodities banker. "Oil margins are under much more pressure."

This role reversal will be one of the main talking points when the world's biggest commodity traders meet for the FT Commodities Global Summit in Lausanne this week.



The heads of trading houses such as Glencore, Trafigura, Vitol, Mercuria and Gunvor — all huge oil traders, but some with more exposure to metals dealing that others — will debate the outlook for an industry that has grown massively in terms of volumes over the past five years.

Glencore chief executive Ivan Glasenberg, in one of his first public appearances since he turned the company's fortunes round following a crisis triggered by a sharp downturn in the commodities markets, is expected to strike a bullish tone around the rise of electric vehicles and its impact on markets such as copper and cobalt.

The miner-cum-trading house, which stands out among its trading rivals for being a publicly listed company, made more than $2bn in adjusted marketing earnings (before interest and tax) in 2017 from its metals division, more than double what it made through oil deals.

For the first time in its 25-year history, Trafigura made more than $1bn last year from metals trading, matching the money it made from oil and products such as diesel and petrol. Mercuria, meanwhile, traded 33m tonnes of metals and Co2 emissions last year.

Following years of under-investment by mining companies, which until very recently have been preoccupied with paying down debt and repairing their balance sheets, supply constraints are becoming evident across many metals markets.

That is a boon for metals, given that demand is also improving as the global economy enjoys its best run since the financial crisis.

The backdrop may be difficult in oil, but no one is standing still. With margins under pressure, the competition for volumes has become more intense.

Vitol, the world's biggest independent oil trader, whose long-time chief executive Ian Taylor last week stepped down to become chairman of the company, traded more than 7m barrels a day in 2016.

Although it is expected to lose some barrels from the end of a five-year offtake deal with Russia's state-backed Rosneft, it has added capacity through the acquisition of Noble Group's oil trading arm.

The back-story

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- Copper is still cheap, despite its surging price
- Zinc joins commodity party
- China playbook is no help in this commodities cycle
- Steel tariffs spark fears of tit-for-tat move on soyabeans
- Saudi Arabia's existential crisis returns as US shale booms anew

While the Noble business has almost certainly shrunk from its 2m b/d peak in 2016, with the Singapore-listed trader hit by an accounting crisis and near bankruptcy, the addition of the Americas-focused operation is still expected to boost Vitol's total barrels traded.

Glencore has also boosted oil volumes to above 6m b/d, according to people familiar with its operations, and up from an average of 5.5m b/d in 2017, as its relationship with Rosneft has strengthened. Mercuria's oil volumes rose to 2.43m b/d in 2017, up from 2.1m b/d in 2016, other people said.

"The only way for traders to make money in oil trading at this stage is to grow trading volume to compensate for the compression of margins," said Jean-François Lambert of consultancy Lambert Commodities.

He added that agricultural commodities, long the laggard of the sector because of bumper crops and limited trading opportunities, were enjoying a rare moment following droughts and failed crops, which have affected key sectors such as cocoa, soyabeans and wheat.

Another bright spot is liquefied natural gas, a fuel experiencing rapid growth in China. For those traders who had the foresight to build a business over the past couple of years, this is providing a prop for their earnings in energy.

To lower costs and protect margins, traders are turning to technology and digitisation, such as cloud-based trading and risk management systems.

Etienne Amic, chairman of cargo tracking company Vortexa and an investor in commodity sector start-ups, said that many trading houses are streamlining back-office functions and scheduling of physical trades using new IT platforms.

Be it metals, energy or agriculture, the benefits of scale in commodity trading are becoming more evident as markets become more liquid and transparent.

“Traders will need to build more sophisticated systems and those investments won’t be insignificant,” said Alexander Franke, head of the commodities trading practice at consultants Oliver Wyman. “That favours the big players.”

Additional reporting by Emiko Terazono