Le dernier mot

Jean-François Lambert predicts that uncertainty created by Brexit and the growing global population mean demand for commodities will soon outpace supply

Last month, I reflected on what could unravel in the world of commodities during the second half of 2016. Brexit was a possibility; a caveat.[1]

Today, the caveat has become a reality and nobody really knows what the outcome of this decision means.

What everybody senses, though, is that we have shifted course. Whether this will be for better or for worse nobody has a clue. Things will simply be different. And because we cannot compare, in retrospect, what 'might have occurred' with what will happen, all hastened comments and every analysis will give very little indication as to what was right and what was wrong. Only history will tell and that will take some time.

Arguably, the world remains as uncertain as ever, with a deeper gap between political elites and the public in western democracies. Whoever manages a business – or nation states for that matter – know that we are bound to live in a globalised, multipolar world and this is what they must try to take advantage of. Yet, nationalistic concerns are at the heart of most decisions made by voters in the aftermath of the great crisis of 2008. Our future be will dictated by the reconciliation of these two opposite perspectives, or lack thereof.

For trade, this matters a great deal. Whereas goods and services flow freely, fostered by global rules such as those of the WTO, or possibly through bilateral agreements such as TTIP and TPP (albeit more and more unlikely), a more dislocated environment will certainly be less conducive. Commodities will have to keep flowing however (this is not open for debate) and energy, agri and even metals are too strategic to be messed about with. No matter what, the numerous clusters of consuming urbanite individuals will need supply, and at all costs.

China and the US to the fore, again

Where does all this leave our world of commodities? With a good number of challenges, but with some bright spots. The challenges are:

- Uncertainty means lower growth. The IMF has just revised its economic outlook down by 0.1% again, with a 3.1% growth only in 2016. Brexit is the culprit here and the secular stagnation syndrome is more than ever a threat. This is obviously good for neither volume of commodity trade, nor absolute margins.
- Volatility is not great. Arguably, uncertainty might boost it but trading conditions remain rather uncertain. This was evidenced in agri where the profit warning of Wilmar, caught on the wrong side of the market in sugar and affected by difficulty in the soy complex, does not bode well for ABCD (ADM, Bunge, Cargill and Dreyfus) performances in 2016 so far.

Yet some brighter spots remain:

- Post Brexit, the Fed is unlikely to contemplate any rate hike before December, i.e. before the uncertainty somehow dissipates. This means the US$ might remain subdued. This will at least alleviate pressure on commodity prices, as an asset class.
- Commodity prices bottomed out in 2016 and while the current environment does not warrant a new super cycle any time soon, there are reasonable evidences that oil price has reached a level which producers and customers can live with.
- China just confirmed it is firmly on course for 6.7% GDP growth in 2016. This is good to very good news for bulk commodities. The IMF however is a touch more prudent with a 6.6% growth in 2016 in its latest estimate, but this should sustain commodity demand from the Middle Kingdom as infrastructure projects accelerate.
- Emerging markets are regaining some lustre through the combination of better commodity prices and the perspective of stable (i.e. low) US$ interest rates. This also mean fewer potential defaults among Brazilian sugar producers for instance.

Increased demand, strained supply

In the long run, our horizon is fogged and Brexit does not make it any clearer. However, some of today's decisions are bound to have a deep impact on the future, and the axing of billions of investment in mining and oil throughout the world is building tomorrow's bottlenecks.

The fundamentals of demand have not changed as the strong momentum of world population growth, through urbanised middle classes, is not abating. Demand is therefore growing, and will continue to grow no matter what. Capacity building has almost stopped however, and from iron ore to copper, through to oil, the question is not if but when demand outpaces supply.

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References
1. See www.tfreview.com/node/13752

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