Le dernier mot

Jean-François Lambert reflects on a brighter picture for commodities and their financiers than that beheld at New Year 2016

Mid-year is an opportune time to take stock of the market dynamics. Despite a rocky start to the year, somehow, the market has become even more dynamic. Remember January's wave of pessimism?

To name but a few concerns at the time, stock markets were down, oil was searching for its low, China was in the quagmire of ever slower growth, and the dollar looked set to be even stronger after December's 0.25% interest rate rise from the Fed, with further rises on the horizon.

Commodity bankers were uncomfortable, merchants circumspect and regulators were (even more) worried.

So far so good

So, where are we today? According to the FT, commodities are the best performing asset class so far this year, ahead of global bonds and global equities. However good this news is, it does not tell the whole story. This year's performance is even more impressive when we recall that from early January to mid February, prices took a further (and sharp) hit. Hence, from 11 February to 14 June, the Thomson Reuters CRB total return commodity index climbed up 24.79%![1]
Looking at the top performers, this is a very impressive hall of fame:

- Oil hovering around US$50/bbl after the Brent hit a low of US$29.40 on 20 January 2016;
- Iron ore (Tianjin 62% Fe) trading at US$52mt, a 22% rise since the beginning of the year and a 40% rebound since December;
- Soybean and soymeal prices rose to an eight-month high;
- Raw sugar above US$19.5 after a low of US$12.77 on 19 February 2016.

Of course, we're not living in a perfect world. Volatility is not great; oil contangos are a pale version of what they were in the last quarter of 2015 (in Singapore, many tankers are idle but more and more of them are empty); copper is still heavily beaten (below US$4,500/mt); China is still exporting its steel and aluminium; the grain and corn inventory are building up; and there is another ominous bearish sign for commodities: a further interest rate rise from the Fed appears to be on the cards.

Merchants are still very prudent about 2016 – several have already advised us that they are unlikely to match last year's results, courtesy of a foregone contango structure. Commodity bankers should be a tad more upbeat (that is if they are not in denial). Producers need more cash and commodity traders will have to utilise their trade finance lines more actively as cargos are getting more expensive. And the combination of both requirements should lead to more structuring along supply chains.

Trend or bush fire?

All in all, this looks quite promising for the second half of the year, something that did not look possible in January. The million dollar question though, is whether this is a trend or merely a bush fire? I believe we have now rebounded from the lows and are building a positive momentum:

1. The world economy is growing, steadily, but growing nevertheless. At more than 3%, it is still on a course to double in 23–24 years. Europe is gradually picking up (better late than never) and negative interest rates across the continent are a great help to bring back fiscal deficits.
2. Oil at US$50/bbl has reached its healthy band (US$45–US$65) and is enough to feed producers (not all of them, arguably, but supply needs to catch up with demand), and is still low enough to underpin the strengthening of the leading economies. The new Saudi energy minister Khalid Al-Fahli, showed his satisfaction of the current level and hinted at a possible production cap to sustain it. This is a strong sign.
3. China's massive infrastructure projects are firmly on the way and while we should not expect iron ore to keep climbing this year, real demand should sustain a US$50/bbl plus level. Concerns about the huge indebtedness of China are fair, but debt is mostly domestic and Mr Xi's top priority is rather Keynisian in nature, so growth and employment will be maintained at any cost, at least for now.
4. El Niño is waning but disruptions have helped trigger the oilseed and grain complexes. Sugar is roaring and this is very good news for beaten-up Brazil.
5. The US dollar seems to lose steam even with the likelihood of a further 25bp hike this autumn (or sooner). Who can afford a stronger dollar in the midst of the elections and when exporters already suffer? HSBC talks about a "feedback loop"[2] whereby a rate rise could even lead to a weakening of the dollar.

I could go on, but on the eve of summer and with the cautious caveat of uncertainty (Brexit, US elections, traditionally nervous August financial markets…), it is not unrealistic and unreasonable to foresee (and hope) that 2016 will be a somehow better year than 2015 for commodity bankers.
If only compliance and regulatory pressure could recede – just a tad – maybe the practitioners could even have a good time and focus on real business after the summer? This would definitely be great news!

Jean-Francois Lambert runs his own consultancy, Lambert Commodities and can be reached at jfl@lambertcommodities.com

References
1. See http://tmsnrt.rs/21qCPN1 at http://financial.thomsonreuters.com
2. See http://bloom.bg/1UDJ2jH at www.bloomberg.com