

Le dernier mot

Jean-François Lambert reflects on the unexpected events 2016 brought and ponders whether the end of the commodities super cycle will be followed by a sequel



The outcome of the Brexit referendum was unexpected, at least by David Cameron. Suddenly, we are in a brand new world where a new government is endeavouring to navigate the UK out of the EU, while keeping the economy afloat. So far so good on that front, but economists (as well as Phillip Hammond, Chancellor of the Exchequer) are rather pessimistic on the longer term.

Also unexpected was the election of Donald Trump to the helm of the largest economy in the world. The outcome of the US vote is adding another dimension of uncertainty upon the world order as we know it. The sheer possibility of a partial withdrawal of the US from global affairs is taken very seriously by China and Russia, two leading juggernauts of the geopolitical world (the third, Europe, has been deafeningly silent on these matters). Their aim is to plot more confident strategies over a strengthened leadership in Asia and the South China Sea for the former, and the reconstruction of a Russian empire for the latter.

Unexpected too, has been the behaviour of commodity markets. Who would have thought last January that coal, iron ore, nickel, zinc and even Doctor Copper would have thrived as they did? What has changed over the past 11 months that could have triggered such a rally? Has the world economy finally lifted from the doldrums?

Not quite. The latest outlook from the IMF is rather grim, with a pale 3.1% growth in 2016 and heightened concerns about the backlash against global trade. Has the US dollar weakened? Again, not quite. In fact, it has strengthened and is well on its way

to reaching an all-time high not seen since 1986. So much for underpinning commodity demand.

Counterintuitive

One might have expected that oil and gold would have been the main benefactors of such an uncertain environment. Indeed, gold was sharply up for most of the year until the election of 'Trump. In a typical 'buy the rumour sell the news' movement, it is now back to its February 2016 level. Oil collapsed in February and has since recovered.

However, further to the OPEC meeting in Vienna announcing the first genuine production cut since 2008, prices surged but the new dynamics of the shale band have, so far, prevented oil from stabilising or climbing more than a few days at or above US\$55.

Unlike metals, agricultural commodities had a more uncertain year despite a well-established pattern of growing demand – so much for fundamentals. Some softs have enjoyed a nice run, such as coffee, soybean and sugar, but cocoa and the grain complex have fared rather poorly.

It is hard to decipher such irrational commodity market behaviours and dwell, post facts, on what was not anticipated. I would nonetheless risk two explanations.

A sequel of the supercycle?

The first answer as to why, notably, the metals and mining sector has had such a good year could be found in Beijing. As growth rapidly lost momentum (keeping in mind last year's discussion over a soft vs hard landing of the Chinese economy), and amid low inflationary pressures, the Chinese authorities have embraced quantitative easing but in the old fashion way: debt stimulus.

Banks have lent massively and this justifies the 6.7% growth level many doubted, has since been firmly reconfirmed. A risky move for a country where debt exceeds 235% of GDP, but one which has boosted infrastructure one more time.

The second reason lies in the fact that investors have come back to the commodity markets, with US\$54bn of inflows from January to August. This has not formed the wave but has certainly contributed to amplify it.

Are we at the outset of a new super cycle? Again, not quite, and I would advise caution. The many consequences of the events described at the beginning of this column have not unfolded yet.

China is on steroids for now but it has yet to prove that it can thrive without. Commodity demand is and will remain a function of economic growth and not much good news is expected there. Investors, finally, may well change their minds once more in favour of bonds for instance.

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References

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