Commodities Outlook 2022: Keeping the faith

'Let the good times roll' was our message coming into 2021 and the commodities complex did not disappoint. In fact, markets exceeded our expectations. And 2022 looks to be another great year. While we see some prices edging lower from their current elevated levels, we expect most to remain above their long-term averages

Commodities are set to be the best performing asset class of 2021, with the Bloomberg Commodity index up around 25% YTD, although it has been up by as much as 35% over the course of the year. Recovering demand following Covid, supply chain disruptions, government policy and adverse weather have all contributed to a tightening in markets this year, which has propelled prices higher.

Going into 2022, we expect the disruptions we have seen in supply chains to improve, while the balances for several commodities will look less tight than in 2021. This should mean that prices edge lower from current levels. But importantly, we still expect them to remain above long-term averages.

There will also be a number of macro headwinds, which should limit further upside for the commodities complex. Firstly, central banks are set to tighten monetary policy over the course of 2022. Secondly, our FX team are forecasting a stronger US dollar next year. Finally, there are lingering concerns over the Chinese property market. If we see a further slowdown within this sector, it will likely put downward pressure on the complex, particularly for metals. However, the risk of this occurring is looking less likely as it appears the Chinese government is becoming a little more accommodative when it comes to policy.

Oil is set to see strong supply growth from non-OPEC nations, which coupled with a further easing in OPEC+ supply cuts should push the global oil market back into surplus. This should put a cap on prices. However, worries over OPEC capacity and the broader lack of investment in upstream production will likely also provide a floor to the market not too far below current levels.

The European gas market is likely to remain tight through winter, which will mean we'll continue to see plenty of volatility over the coming months. The end of the heating season should bring weaker prices. Seasonally, though, they will still be high given the need to replenish inventory over the injection season.

The balances for most metals also look relatively better next year, which suggest that prices will edge lower from current elevated levels. They are still, though, expected to remain above their long-term averages. Inventories are low amongst several metals, whilst sentiment around the outlook for demand in the medium term is constructive due to growing investments in green projects, which happen to be metal intensive. We are most bullish about aluminium going into next year. The aluminium market is heading into a period of structural deficits and there is no quick fix to resolve this; we should see prices trading higher.

Precious metals are likely to struggle the most over 2022. Tightening from central banks around the world, along with expectations of further USD strength should mean investment demand for gold remains poor. The only scenario where we see further upside for gold prices is if we see central banks doing a U-turn on tightening. A potential catalyst for this would be further severe waves of Covid-19.

We would expect agricultural commodity prices to ease through next year but again they'll remain above long-term averages. The wheat market has traded to multiyear highs due to weather hitting crops from a number of key producers. Assuming normal weather in 2022, wheat should see ending stocks edging higher. There is uncertainty for sugar and coffee going into next season with La Niña weather risks building in Brazil. The coffee market has already suffered from drought and frost damage. How much of an impact this will have on next season's crop will depend on precipitation over the rainy season. Given the uncertainty, coffee prices are likely to remain elevated until the market gets a better idea of how big Brazil's next crop will be.

So overall, while we see some marginal downside risks across the commodities complex in 2022, on a historical basis prices are likely to trade at elevated levels for another year. The key risk, of course, is the coronavirus pandemic. Overall, we're keeping the faith.

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