Commodities: Losing momentum

Parts of the commodities complex appear to be running out of steam, with downward corrections seen in metals and agriculture over June. However, energy remains well supported, and the short-term outlook will largely depend on OPEC+ policy

Minister of Energy of the UAE, Suhail Mohamed Al Mazrouei attends a meeting of energy ministers from OPEC and its allies

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Oil bucks the trend

While large parts of the commodities complex came under pressure in June, the energy segment remains well supported.

Oil prices have hit levels last seen in 2018, with Brent edging closer towards US$80/bbl. Recovering demand and concerns over an increasingly tight outlook have pushed prices higher. OECD oil inventories are now back in line with the 2015-19 average, highlighting the great job that OPEC+ has done in rebalancing the market. But the key for price direction will continue to be OPEC+ policy. The group has a significant amount of spare capacity, to meet the expected increase in demand, however, OPEC+ are taking a cautious approach, and so are reluctant to bring additional oil to the market without knowing there will be demand for it. This approach means that downside in oil prices will likely be limited, assuming we do not see a breakdown in the broader deal. While the market is certainly in a healthier state than it was last year, there are some concerns that the market may be getting a bit ahead of itself.

Fundamentally, it is difficult to justify Brent trading above US$75/bbl for a sustained period and we believe OPEC+ will come to a compromise to gradually increase output

Firstly, refinery margins remain weak, and if demand was as strong as prices suggest, one would expect margins to be stronger. In addition, OPEC+ are still taking a cautious approach, which possibly means that the physical market is not as tight as the futures market suggests.

Clearly, investor sentiment is a key driver for oil prices at the moment and will likely continue to prop up the market in the near term. But fundamentally, it is difficult to justify Brent trading above US$75/bbl for a sustained period. To see prices moving higher for longer, we would need to see the recent breakdown in OPEC+ talks leading to unchanged production from the group in the months ahead. We think this is unlikely and believe that OPEC+ will come to a compromise to gradually increase output.

The Fed & action from China rattles metal markets

There has been increased volatility in the metals markets over the last month.

The Chinese government has attempted several times to cool down rising prices, with varying degrees of success. Part of this intervention includes cracking down on speculation within the domestic market, whilst also finally confirming the release of aluminium, copper and zinc from state reserves. While this has provided some downward pressure in the short term, the effect on prices is likely to be rather short-lived. The market was underwhelmed with the volumes that the Chinese government was offering in the first stock release.

We believe copper prices have peaked for now

However, what has more potential to weigh on the market is the policy from the US Federal Reserve. The Fed is becoming increasingly hawkish, with expectations of rate hikes brought forward, along with the possibility of tapering asset purchases. This along with some renewed strength in the USD has the potential to weigh on the metals complex.

Fundamentally, we are also seeing signs at least in the copper market, that the previous tightness witnessed is easing. If we look at China, copper cathode import premiums are at multiyear lows, with downstream buyers remaining on the sideline in this relatively higher price environment. LME copper inventories have also grown significantly, and are currently at the highest levels since July last year. Copper concentrate supply also appears to be improving with treatment charges in China edging higher from the recent lows. Finally, the copper market is set to move from a deficit environment this year to a surplus next year, with a new mine supply coming onto the market.

A combination of macro and fundamentals suggest the copper market will find it difficult to return to the record levels seen in May, and as a result, we believe copper prices have peaked for now.

A volatile summer likely for agriculture

Like the metals complex, we have seen increased volatility in the agricultural space recently. Prices fell from their multiyear highs, with an improvement in weather conditions in the US, which helped to ease some concerns over the US corn and soybean crop.

The upcoming season should see global stocks for grains and soybeans edging higher, which suggests that prices should trend lower, particularly as we see new crop supply coming to the market later in the year. However, for now, the market will likely be sensitive to how the weather in the US develops over the summer. Hot and dry weather has the potential to push markets higher.

This is particularly the case, following downgrades to the Brazilian corn crop, given the drought conditions seen in the region this year. To make matters worse for Brazilian farmers, parts of Brazil have also witnessed frost more recently, which could lead to further downgrades to the current Brazilian safrinha corn crop.

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