

Commodity supercycle calls grow

It has been an exceptional month for commodity markets, with growing inflation expectations increasing investor interest in the complex. Meanwhile, fundamental developments, particularly in the oil market have only provided a further boost. We still see further upside for oil as we move through the year



Oil pump jacks work in unison, Williston, USA

Source: Shutterstock

Investors flock to commodities

The commodities complex has had its best start to the year since at least 2008, with the Bloomberg commodities index finishing February more than 9% up since the start of the year, whilst recently the index had been up as much as 12% YTD.

We have continued to see increased investor interest in commodities with the expectation that as we see a global recovery from Covid-19 it will be bullish for commodity demand. In addition, given the loose monetary policy we have seen, coupled with fiscal stimulus, inflation expectations have only grown in recent months, which has increased the attractiveness of commodities for investors, given they are seen as an inflation hedge. Meanwhile, the broader weakness that we have seen in the US dollar for much of the last year has only provided further support.

All parts of the complex have seen a boost in speculative interest, including metals, agriculture and energy. If we look specifically at oil, the managed money net long position in ICE Brent stands at

almost 350k lots, levels we last saw back in February 2020, and up around 292k lots from the lows seen in March last year. What is also interesting has been the fact that speculators have been increasing their spread positions in the oil market, and given that the forward curve has flipped from contango to a fairly deep backwardation, this shouldn't be too much of a surprise, given the positive roll yield on offer.

However, if speculators are buying the oil market, there needs to be someone who is selling it, and positioning data shows pretty clearly that as we have seen the market rally, producers have been happy to hedge into this strength. The producer short position in ICE Brent is the largest we have seen since late 2019. For NYMEX WTI, the producer short has recently been at its highest level since 2017. It is pretty clear though, that this producer hedging in the oil market has provided little resistance to the market moving higher.

Are we entering a new commodities supercycle?

As commodities have rallied this year, more market participants have suggested that we are at the start of a new commodities supercycle. So, what exactly is a supercycle? It is an extended period of time where you see above-trend movements across large parts of the complex. A supercycle can last for decades, and the last one was back in the early 2000s, with rapid growth in China driving strong demand for commodities. That cycle lasted basically from early 2000 all the way until around 2014.

The sizeable amount of fiscal stimulus, along with loose monetary policy that we have seen over the last year to help with the post Covid-19 recovery is certainly a supportive factor for commodities demand. This is already evident when looking at the strong post Covid-19 recovery from China. Sizeable stimulus in China has boosted infrastructure projects and as a result, demand for commodities. All across the complex, China has featured as a strong buyer, with record oil, iron ore, copper and certain agri imports in 2020. If we are to see the start of a new supercycle, this robust demand growth that we are seeing from China will have to be sustainable for several years. This is something that we are less likely to see. However, China can still be the catalyst, we will just need to see other economies coming through with stronger demand growth. Energy transition has the potential to provide this. Investment in renewable energy infrastructure would provide a significant boost to demand for commodities, although this would be more beneficial for metals than fossil fuels.

On the supply side, a lack of investment does mean that markets are left potentially quite tight further out, supporting the idea that we could be at the foothills of a supercycle. Although for oil, US shale may be a limiting factor for prices rallying too strongly. During the previous supercycle, US shale was still in its infancy, and so producers were unable to respond quickly to stronger prices. However, with the US shale industry now more mature, their response to higher prices should be quicker.

Overall, while there are a number of factors which suggest that we could be at the start of a supercycle, we still believe it is too early to call. We would need to see robust and sustainable demand growth in the years ahead.

Oil balance set to continue tightening

We came into 2021 with [a bullish view for the oil market](#), but clearly Saudi Arabia's additional supply cuts, US supply disruptions due to freezing cold conditions, growing demand hopes, rising

inflation expectations and the broader USD weakness have meant that the market outlook is even more bullish than we had anticipated.

As a result, [we recently revised higher our oil forecasts](#), and now expect ICE Brent to average US\$65/bbl over 2021. While we see limited further upside in the first half of this year, it is over the second half of this year where we see more upside, given the expectation of a stronger demand recovery over this period. The continued tightening in the oil balance means that we see Brent trading at US\$70/bbl by year-end.

Downside risks for oil

However, there are still clear downside risks. Firstly, while we are seeing the rollout of vaccines, there is the risk that we still see further waves of Covid-19, which would weigh on demand. Secondly, in the near term, higher prices could see some buyers hold back. In recent weeks, Chinese buying seems to have eased. Thirdly, a swift return of Iranian barrels could slow the market rebalancing process. However, for now we do not see a significant return of Iranian supply until later this year at the earliest. Finally, there is always a risk that OPEC+ fails to agree on the next steps with regards to production cuts at its meeting on 4 March.

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