Tighter fundamentals and geopolitics are pushing commodities higher

Commodities, in general, have been performing strongly since early March. While high oil and gold prices have been extensively covered, they've been dwarfed by cocoa and silver. Here's why

Oil and gold have been particularly strong performers this year

Oil market tightens as geopolitical risks grow

Oil prices have seen significant strength through March and early April. ICE Brent broke above US$90/bbl, trading at its highest level since October. Growing tension in the Middle East is obviously one reason for the boost. However, that increased geopolitical risk comes at a time when the oil market was already set to tighten.

The oil market has been pushed into deficit after a handful of OPEC+ members announced they would roll over their additional voluntary cuts, amounting to 2.2 million barrels a day (b/d) from the first to the second quarter of 2024. Our numbers suggest this will leave the market in a deficit of around 1 million b/d this quarter.

The scale of the deficit suggests that oil prices remain well supported over the coming months and as we enter the summer driving season through the third quarter. As a result, we expect ICE Brent to average $88/bbl over the second and third quarters.

OPEC+ will be key to the outlook for the second half of the year. Additional voluntary cuts are set to expire towards the end of June. As a result, the market is set to be in a small surplus over the second half of 2024. However, the key upside risk is if OPEC+ decides on a further rollover, which would tighten the market still further. If that happens, we'll be looking to revise our forecasts higher still.

Europe exits winter with record gas storage

Europe has exited the 2023/24 heating season with record natural gas storage. It was 58% full at the end of March, above the 56% we saw last year and well above the 5-year average of 41%. Comfortable storage has kept the market from moving significantly higher. Gas flows into Europe have been stable through most of the winter, while we have had some milder weather through February and much of March.

We expect prices to remain under pressure through the injection season. With storage likely to be full once again ahead of next winter, we could see prices coming under further pressure later in the third quarter. We expect TTF to average EUR25/MWh over 2Q24 and 3Q24.

There are some further signs of gas demand recovering in Europe, with some Year-on-Year increases in gas consumption in recent months. However, demand remains well below pre-Ukraine war levels. Our gas balance suggests that European gas demand in 2024 could increase 9% YoY, and Europe would still manage to hit the European Commission's target of having storage 90% full by 1 November.

As we approach the end of this year, a concern for the market is what happens to Russian pipeline flows to Europe via Ukraine. Ukraine has made it clear that it has no plans to extend the transit deal with Gazprom, which expires at the end of December. This puts roughly 40mcm/day of Russian pipeline flows at risk. We believe that Europe will be able to find an alternative supply if this volume is lost. However, the market is still likely to react to such a development.

Precious metals defy higher rates

Spot gold prices have hit record highs, trading above $2,350/oz, and the market is up around 13% since the beginning of the year. The precious metal has had a record-breaking run since mid-February, boosted by expectations for US rate cuts, geopolitical tensions, and China's economic woes.

US Federal Reserve policy is gold's main driver. There's optimism it'll soon cut rates, but it wants to see more evidence that inflation is a tamed beast. We're expecting interest rate cuts this year, but if it continues its cautious approach, gold prices risk pulling back.

The prospect of the Fed's monetary easing has also benefited silver, which has surged along with gold, up 16% since January to its highest levels since 2021. Silver's advance has come with an increase in ETF holdings. That contrasts gold, which is yet to see a rebound in ETF demand. Investor holdings in gold and silver ETFs generally rise when prices gain, and vice versa. There is plenty of room for investors to buy the gold market, but maybe we need to wait for the Fed to start cutting rates before investors jump fully into the market.

We expect gold prices to trade higher this year as safe-haven demand continues to be supportive amid geopolitical uncertainty with the ongoing wars and the upcoming US election. We have revised our 2024 gold forecast higher, and we now expect prices to peak in the fourth quarter, averaging $2,300/oz. We expect an average of $2,206/oz in 2024, assuming that the Fed starts cutting rates in the second half of the year, along with weakness in the dollar and treasury yields, while geopolitical risks continue to linger.

Tight concentrate market drives copper prices higher

Copper is trading at its highest since the middle of 2022, up 10% so far this year, fuelled by supply risks and improving demand prospects for metals used in the green energy transition. The main catalyst for copper's rally is the unexpected tightening in the global mine supply, most notably First Quantum's mine in Panama, which has removed around 4000,000 tonnes of the metal from the world's annual supply.

Copper smelters in China have pledged to curb output in response to a tightening copper ore market and following a collapse in spot treatment and refining charges to record lows. The global refined copper market was expected to be fairly balanced this year, but the shortfall in mine supply now means that the market is likely to be in a deficit.

At the same time, demand uncertainties remain. China's property market has been a major headwind for copper demand, and a continued slowdown in the sector is the main downside risk.

In the short term, the upside to copper prices might be capped by macro drivers, including ongoing demand concerns in China and lingering uncertainty over US monetary policy. However, micro dynamics are starting to look more constructive for the metal amid a tightening supply outlook. We see copper prices rising in the second quarter, traditionally its strongest season for demand, to $9,050/t on average from an average of $8,539/t in the first.

We see prices peaking in the fourth quarter at $9,100/t. They will, however, remain volatile as the market continues to respond to macro drivers, including the path of US interest rates and Chinese policies.

Cocoa deficit concerns intensify

The cocoa market continues to defy gravity, with London cocoa surging through GPB8,000/t to a record high of GBP8,690/t in early April. Prices have rallied in the region of 140% this year after rising 70% in 2023.

The key growing region of West Africa is the cocoa market's biggest concern. Disease-plagued crops have been met with dry weather, which has weighed heavily on supply. Ivory Coast, the largest producer, has seen farmers deliver around 1.3mt of cocoa to ports so far in the 2023/24 season, down from around 1.8mt over the same period last year.

Crop shortfalls not only mean that the global market will see its third consecutive deficit. But at around 400kt, the 2023/24 season will see the largest deficit in more than half a century.

Given there's no quick supply response for cocoa, demand will have to do the work to try to balance the market. We will need to see prices stay higher for longer to ensure adequate demand destruction. In 2023, demand was weaker, with grindings in Europe, Asia and North America down around 4% YoY. Many chocolate producers would have had hedges in place, helping to shield consumers from higher prices. Eventually, however, chocolate producers will need to pass on higher costs, which should hit demand more aggressively. Grinding data for the first quarter of this year for key regions will only be available over the second half of April, and that will shed some light on whether we are seeing more aggressive demand destruction due to the high-price environment.

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