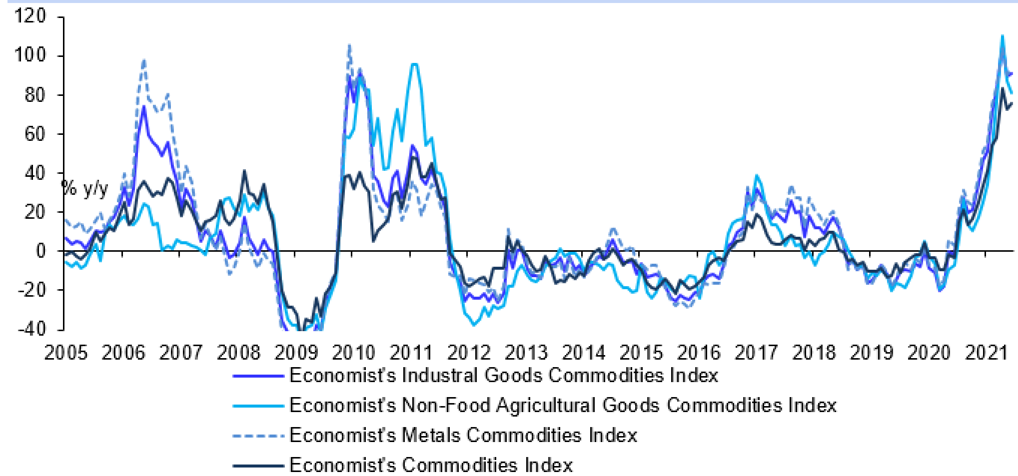
SA Economics

Tuesday 15 June 2021

Gold & Commodities note: commodity prices have seen some consolidation in June, after a very heady run since the middle of last year, with concerns building in markets on QE tapering as inflation heats up globally

Economist's commodity indices



Source: IRESS, Economist

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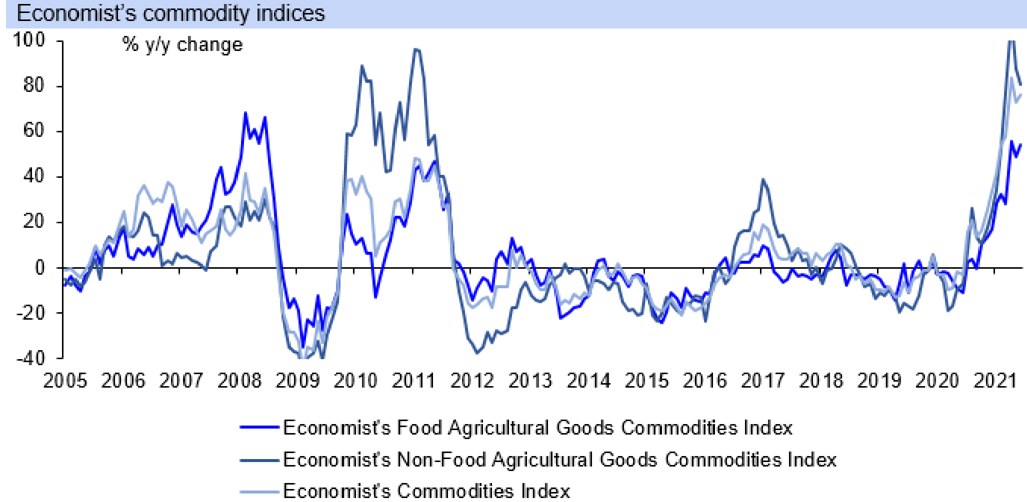
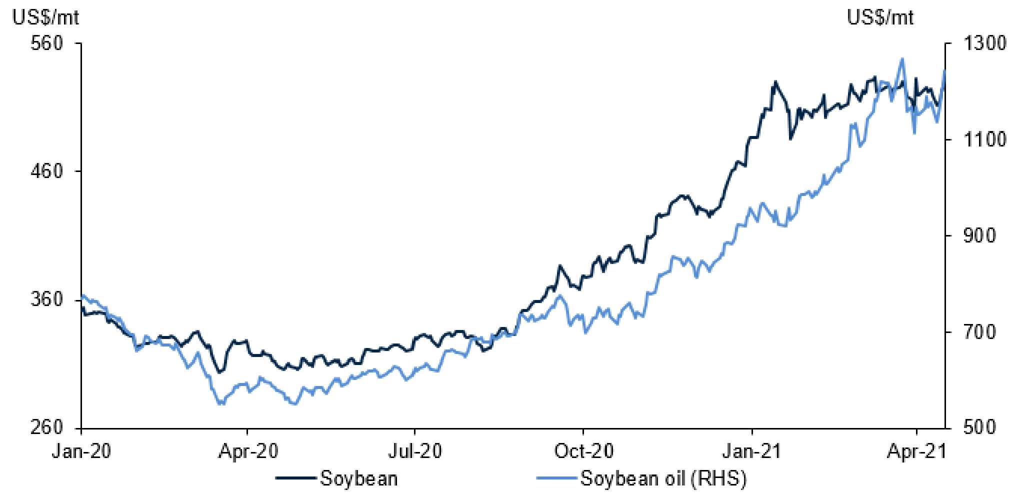


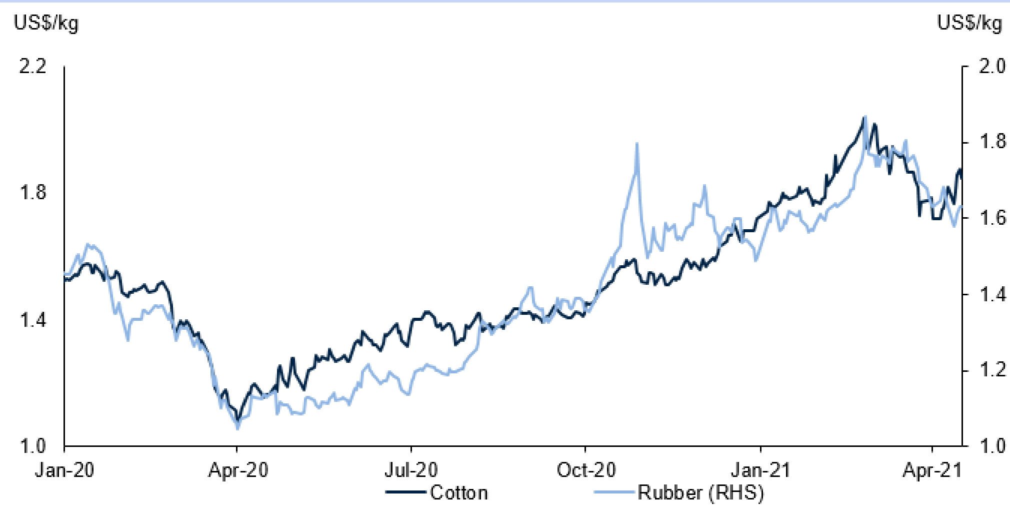
Source: IRESS, Economist

Wheat and maize prices



Source: World Bank, Commodity Markets Outlook April 2021

Agricultural raw material prices



Source: World Bank, Commodity Markets Outlook April 2021

- Commodity prices essentially retained their levels overall in June, but on a disaggregated basis show some slight weakness in industrials and metals, but some small strength in agricultural food, with resultant consolidation overall after a heady near twelve month run.
- This follows on a moderation in the monthly pace of ascent of commodity prices this year, with the second half of last year having seen a quicker pace, but commodity prices have still reached ten-year highs this year, very close to the 2011 peak of the 2000s commodity boom.

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- Indeed, the 2000s' commodity super cycle was driven by both accelerating demand from the rapidly growing emerging market economies (particularly the BRIC nations) and supply side constrains in the face of such lengthy growth in demand, after prior depressed prices.
- The Economist commodities price index shows a rise in 2000 from close to 60 index points to 189.7 in 2011, while since April last year the index has risen from 100.7 to 188.8. While currently not a super cycle, the acceleration since last year has nevertheless been rapid.
- Year on year, the index shows commodity prices are currently up 76% overall, while metals prices are up 93% y/y and industrials are 78% higher than a year ago, and non-food agricultural prices 81% higher y/y (all Economist commodity price index).
- Food commodity prices are, in comparison, only up 41% y/y, strong showing for food prices which experienced deflation in many periods since 2011, and have also been driven higher over the last twelve months by growing global demand, along with the other commodities.
- Indeed, the global PMI reached a fifteen year high in May, with demand for new orders and production output at the fastest pace since 2006, led by the US, the Euro area and the UK (as measured by the J.P. Morgan Global Composite Output Index).
- International trade has strengthened materially, with new export business at a peak in the global composite J.P. Morgan PMI's series, evidencing strong demand pressures persist, although supply shortages remain, and that price inflation is at its quickest pace since 2008.
- With the FOMC meeting tomorrow evening, SA time, market expectations are for the Fed to potentially provide some deeper insight on its inflation views, which could feed market concerns on the timing of future QE tapering, although the Fed is likely to be judicious in this.

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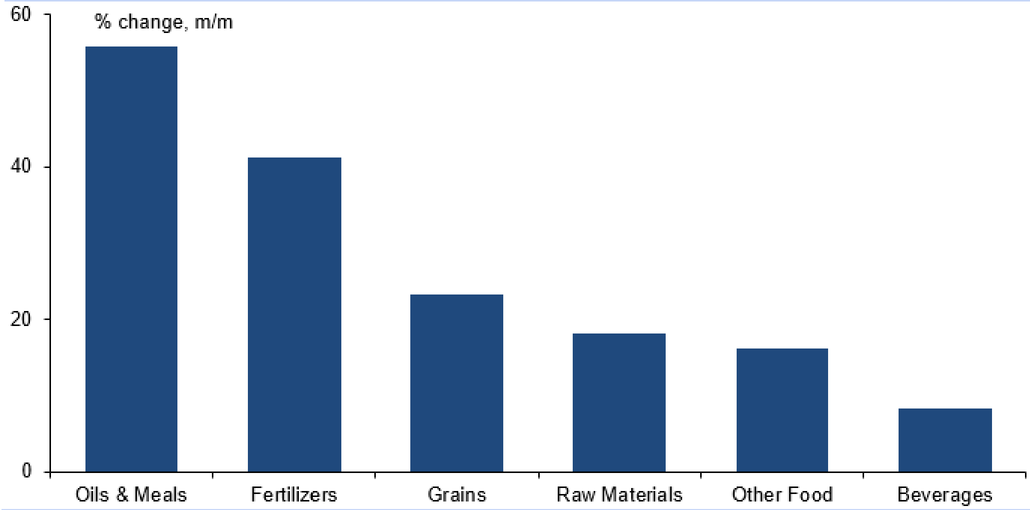
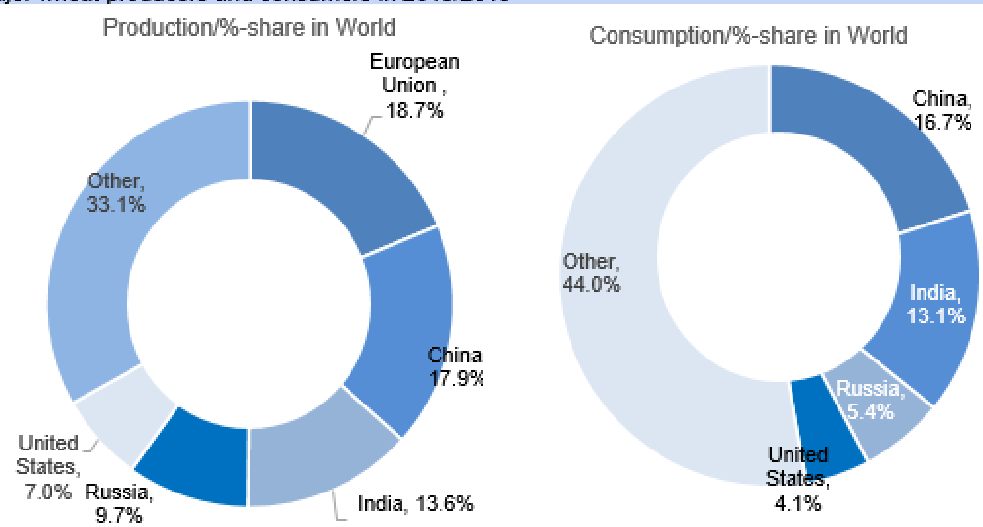
Commodity index changes, January 2020 to March 2021



Source: World Bank, Commodity Markets Outlook April 2021

Major wheat producers and consumers in 2018/2019



Source: FocusEconomics

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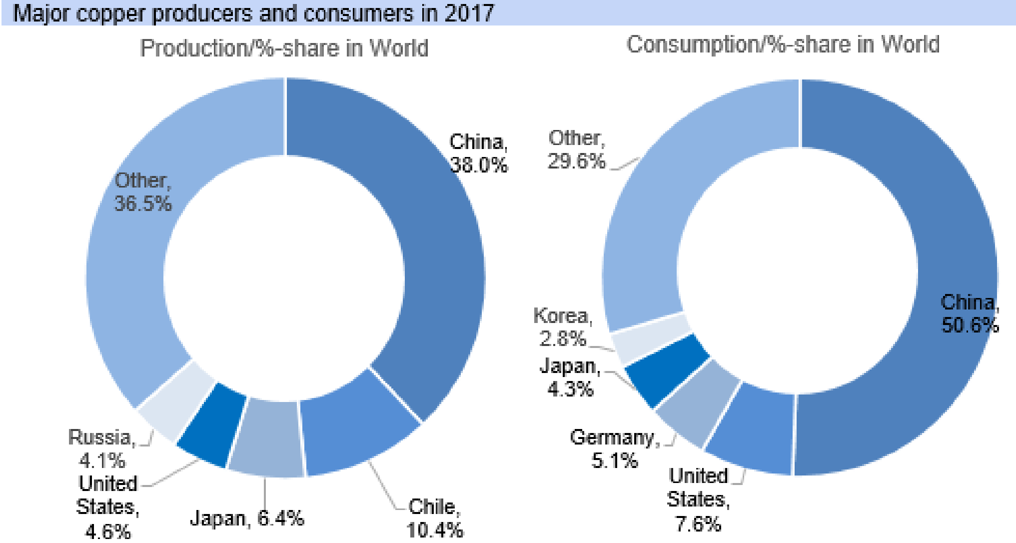
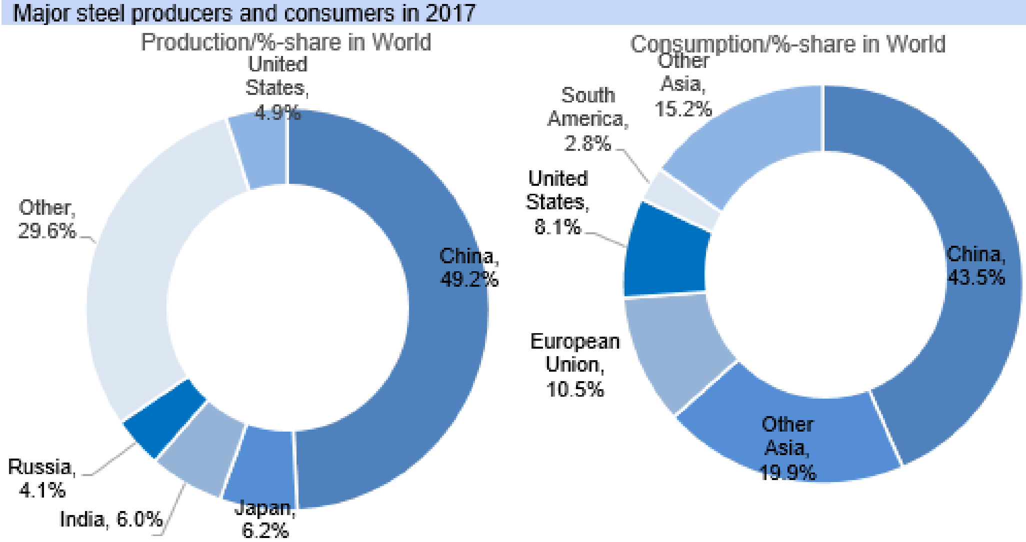
Major copper producers and consumers in 2017



Source: FocusEconomics

Major steel producers and consumers in 2017



Source: FocusEconomics

- Optimism on future global economic activity is strong, with the J.P. Morgan global PMI (complied by IHS Markit and J.P. Morgan in association with ISM and IFPSM) showing service providers and manufacturers believe output will expand further over the next twelve months.

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- June’s consolidation in commodity prices was to be expected, after the very heady run so far, and will doubtless provide some relief to monetary policy makers which are starting to eye future inflation outcomes, after the current jump up on base effects wear out.
- The base effects of the collapse in commodities prices last year fuelled the base effects causing the recent leaps in inflation recorded around the world for April, and expected again in May. Inflation is likely to remain elevated over the rest of 2021 too on these base effects.
- Indeed, both commodity prices and inflation are likely to remain elevated this year, supported by the economic recovery in the US, and globally, with some further modest strength at times, gradually adding to global inflationary pressures.
- The June lull in commodity prices is consequently a positive for global inflationary pressures, and for commodity prices themselves, which risk becoming overheated without periods of consolidation, although expectations of future inflation lifts have also driven commodity prices.
- That is, anticipation that demand for, and hence the price of commodities, would rise in the future has been instrumental in fuelling commodity price increases in the second half of last year, and into this year, with the jump up in inflation now occurring over April and May.
- This circuitous loop fuelling commodity prices is not at an end yet, and commodity prices are not expected to collapse. Low inflation (low price indices) last year will continue to boost inflation this year, with April and May just the start of this base effect.
- Consequently, US and global inflation will feel these effects into next year’s first quarter, while expectations of future global growth, and so of economic demand, will also support inflation expectations. From Q2.22 the inflation environment will see the base effect wear out.
- The Fed is expected to look though (or ignore) this twelve-month period of base effects, and take a view on 2022 and 2023 inflation and so its dovish monetary support, which is likely to persist this year, and the recent stagnation of the gold price reflects this.

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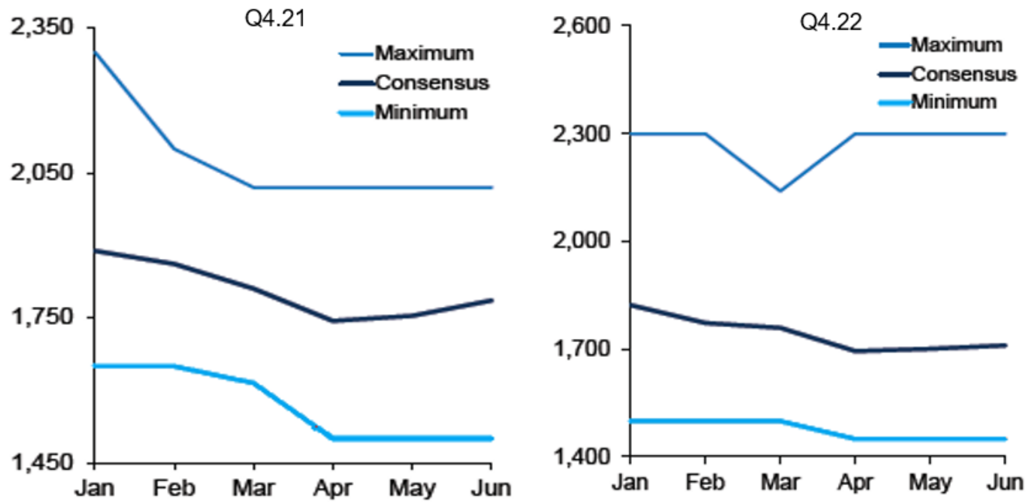
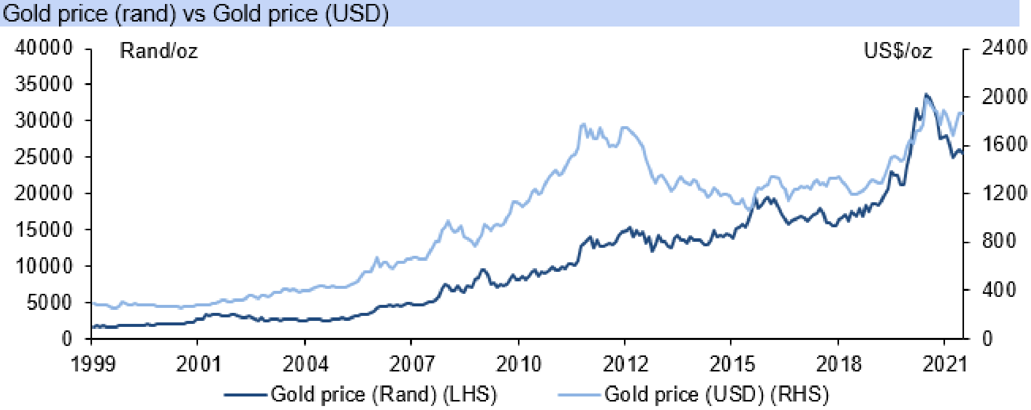
Gold – Q4.2021 and Q4.22– evolution of forecasts



Source: FocusEconomics

Gold price (rand) vs Gold price (USD)



Source: IRESS

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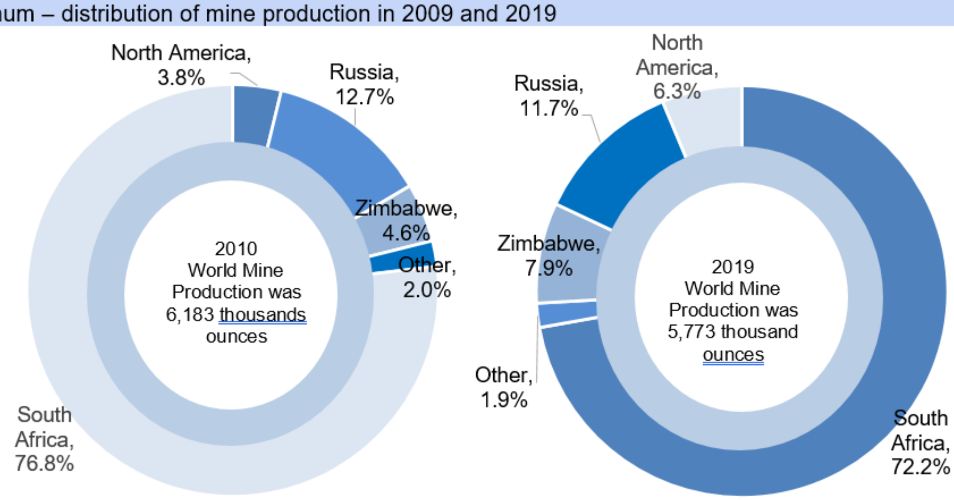
Gold price vs USD index

Source: Iress

Platinum – distribution of mine production in 2009 and 2019



Source: FocusEconomics