TRENDS IN COMMODITIES
In recent years, increasing global tensions have manifested themselves in ways that continue to have an impact upon commodities. The current set of trends impacting supply and demand and pricing of commodities are primarily the global economy, geopolitical tension, changing consumer behavior and the regulatory environment, and they have combined to keep commodity prices essentially flat over the first three quarters of 2019. The outlook for non-energy commodities remains one of weaker demands due to slow economic conditions, if not recession in some economies, while traditional safe havens like gold may see rising but volatile prices. This paper examines some of the primary trends in commodities and looks at some of the potential impacts.
Recession – To be or not to be

A progressive slowdown in global economic growth suggests that both demand and prices for many commodities will remain fairly weak. The International Monetary Fund (IMF) cut its forecast for global growth recently to 3.2 percent, the weakest rate since 2009, and downgraded its expectations for 2020 to 3.5 percent. According to the IMF, “After strong growth in 2017 and early 2018, global economic activity slowed notably in the second half of last year, reflecting a confluence of factors affecting major economies.” And it noted that “GDP releases so far this year, together with generally softening inflation, point to weaker-than-anticipated global activity.”

For many years, China and Asia have been the economic powerhouses that fueled growth, but there too things are slowing. China has experienced the “fastest sustained expansion by a major economy in history” according to the World Bank, but now the IMF projects that its GDP growth will slow each year over the next six years, falling to 5.5 percent in 2024. India has followed suite and its economy is also slowing to a year-on-year 5 percent growth rate in 2019; the Asian Development Bank (ADB) has cut forecasts for most Asian economies, including India. Meanwhile, in Japan, exports declined for the eighth month in a row in July, sparking fears of a recession as consumer sentiment hit a record low.

In Europe, an even worse picture appears to be emerging as both the German and UK economies shrank in the previous quarter, with some degree of concern that Germany may already be in full-scale recession while its manufacturing industry recession deepened. In the UK, the economy also contracted in the three months to June and deep uncertainties around BREXIT continue to plague the economy. Europe as a whole also shows signs of slowdown as growth fell to the lowest levels since 2013 in Q2, 2019 to just 1.4 percent.

The US economy has also been giving mixed signals with weaker business investment and a manufacturing slowdown (hitting the lowest level since 2009 in September 2019) but its Q2, 2019 growth rate was 2 percent. US treasury yields have plummeted and at times, also suggest recession. Meanwhile, central banks have acted to cut interest rates in order to spur activity, including the Australian central bank setting record low rates and the US easing rates last month. A relatively strong US dollar has additionally had the effect of keeping commodity prices higher in other currencies, but in recent months, the Feds have shown some indication that it may continue to lower interest rates.
Trade wars, disputes and sanctions

Global tensions are rising and are manifesting as international economic disputes, social unrest and military conflict. Some examples can include: the US-China trade war; continuing economic sanctions against Russia; tensions in the Ukraine; BREXIT (including the possibility of a ‘no-deal’ Brexit); escalating tensions between the US, Saudi Arabia and Iran; large-scale protests and social unrest in Hong Kong; and the political uncertainty in various nations in connection with recent or upcoming elections.

Commodity markets can react to such events in many different ways, but they are mostly impacted by disruption to the supply chain and sourcing. Other impacts can be price volatility, supply or demand loss, and increased financing and transportation costs, among others. Indeed, some of the lower global growth can be pinned firmly on the geopolitical situation in which the US has engaged in trade wars and disputes with China, the EU, and other regions and nations. Tit-for-tat tariffs have had an impact and appear to be getting worse as the WTO has ruled that the EU illegally subsidized Airbus and the US will now set tariffs on $7.5 billion worth of goods in retaliation. The China-US trade dispute is having an impact that is increasingly being felt globally, sending equity markets into retreat and placing further pressure on economic growth around the world. These trade wars are also directly impacting supply chains for commodities in terms of sourcing, risks and costs.

Other disputes and sanctions are also influencing commodity supply and pricing such as those placed on Iran and Russia for example. In the former case, although the primary target is oil and petrochemicals, it has a knock-on effect into other commodities. On the other hand, the Russian sanctions have also targeted individuals and their assets, and these have affected commodity supply in particular for aluminum as a result of the sanctioning of Rusal. These sanctions have now been lifted. Other geopolitical events have also impacted commodity supply, demand and prices, for example, the recent bombing of Saudi oilfields led to a temporary increase in oil prices and had a knock-on effect across other commodities.

In the commodities market everything can change in an instant. A US-China trade deal, a terrorist attack on infrastructure, or a new set of sanctions can trigger an economic crises, making effective risk management a key attribute of a commodity firm.
Social and environmental issues

In the West in particular, consumers and activists are becoming increasingly concerned by social and environmental issues and this is now having a bigger impact on commodity markets. Many consumers will willingly pay a premium for products that can be verified to be green, carbon-neutral or sustainable. At the same time, many governments have enacted more regulation around child labor, deforestation and other issues that can impact commodity sourcing. A recent law enacted in the US, for example, allows the seizure of any imported goods suspected to have involved child labor and the importer can be held responsible. This places the onus of proof squarely on the importer.

Traceability has therefore become even more important than it was, with a need to be able to track from source to point of consumption in order to prove that there were no illegal or unsustainable practices involved in the sourcing of the product. If a product is sold at a premium and branded as environmentally sound, the consumer must also have faith, and the ability to check, that it was. As well as making traceability more important, this trend is also having an impact on sourcing where greater checks and monitoring may be required to ensure compliance. Being able to demonstrate a socially responsible supply chain has become important.

Regulation and oversight

Other regulations and greater oversight on the part of regulators and stakeholders are also having an impact. Although most of the regulations put in place as a response to the financial crisis of 2009 are now defined, many are still being refined and amended. Despite that, regulators are now levying large fines for bad behavior to demonstrate that these regulations have teeth. Stakeholders such as lending banks are also demanding greater visibility into business processes and risk management. As a result, those involved in the commodity industries are having to comply and pay greater attention to all forms of risk management. Other regulations are also having impact, like the above-mentioned child labor law in the US or the International Maritime Organization’s new regulation that calls for the sulfur content in marine fuels to be reduced, which is affecting freight rates and costs. Meanwhile, position limits may also have future impacts on commodity trading and pricing.
Other trends of note

Commodity markets are also undergoing change with new venues and instruments being launched, particularly in Asia, providing more liquidity and an enhanced ability to hedge exposures. More traditional commodity markets are also shifting, and more electronic trading is taking place in commodity markets today – with much of it being conducted by robots. The Commodity Futures Trading Commission’s market intelligence branch recently looked at several of CME’s markets and found that in livestock futures, such as cattle and hogs, automated trades were two-thirds of the market last year, up from 46 percent in 2013, for example. This move to automated trading in commodities is not only helping make markets much faster but also increasing the risk of a disconnection of pricing from fundamentals in response to an algorithm.

As trade margins have declined across all commodities in recent years, automated trading has increased in popularity, helping firms to react faster. However, more attention is also being paid to the entire supply chain where optimization and increased effectiveness can help drive out some of the costs and operational risk. Here, themes like digitalization, artificial intelligence (AI), more focus on data management, machine learning (ML) and even distributed ledger technologies, like blockchain, are being looked at ways to reduce manual and paper processes and increase the speed and accuracy of transactions across the supply chain. For example, Cargill is applying ML and AI eavesdropping on chickens to identify health and well-being issues before they become visible to the human eye. It has also been using similar approaches at fish farms to optimize feeding. Such technologies are being increasingly applied in all aspects of the supply chain in order to increase efficiency and drive down costs and risks.

Commodities outlook

Any entity with an exposure to commodities – from a producer to a food and beverage company – is impacted by commodity prices and volatility. While slower economic growth, coupled with adequate supply of most commodities, suggests the lower commodity prices are in store, the current global tensions provide a significant geopolitical risk where an event can turn markets volatile in seconds. This can be magnified potentially via automated trading and robots acting in real time against some pre-programmed algorithm. This means that managing exposure and risk is more critical than ever, especially as the regulators and stakeholders are scrutinizing this area as well. It’s not just about managing price and credit risk but also operational risks along the entire supply chain and trying to model those risks via stress testing.

On the operational side, it is increasingly about speed and agility while turning data into actionable insights for profit. This is where digitalization and technologies are being deployed in supply chains to do everything, from monitoring a supplier’s adherence to regulations and best practices to optimizing assets and increasing collaboration with supply chains to enhance effectiveness and reduce risks. Increasingly, much of this activity is also being conducted in the cloud in order to reduce and optimize costs.

In commodities, everything can change in an instant. A US-China trade deal or a terrorist attack on infrastructure, a new set of sanctions or an economic crisis – any of these events can change everything, making risk management a key attribute of any commodity firm.
Contributors

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