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The commodity supercycle – fact or fiction?

Since the start of 2021, the financial press and certain corners of the trade press have been speculating about whether we are at the beginning of a new commodities supercycle. Opinions from those in the industry that experience market fluctuations first-hand have, however, been in relatively short supply.

We spoke to a trader of soft commodities and to Steven Spencer ("SS"), a trader of metals and other commodities with 50 years' experience, to ask if there was any substance to the hype.

What is a commodities supercycle?

At its most basic, a supercycle is a prolonged trend upwards in commodity prices across the board, most commonly caused by a structural change in global demand.

When have they happened previously?

The most recent example was in the early 2000s with the arrival of China as a global player investing in tech and infrastructure. Prior to that, the best examples were in the late 19th century (following industrialisation of the US) and in the 1950s, post-war.

What has caused them in the past?

SS's view is that they tend to occur in periods of very low interest rates when there are also fears of imminent inflation. Long periods of underinvestment in infrastructure, such as mining or oil exploration, when met by an economic boom, as in the recovery period of the 2000s, can also produce a supercycle as demand outstrips supply.

Our softs trader agrees that the driving force for any price rise is classic demand/supply economics: where supply is low and demand is high, prices are likely to rise.

Neither of our traders is convinced that a supercycle is likely, more that COVID-19 has led to a year or so of abnormal supply and demand that will even out in the medium term.

COVID-19 has led to a consolidation of players in many markets, but this is likely to have an effect in the short term only, as they adapt to increased demand.

In terms of agricultural commodities, from a practical perspective fewer people have been able to get into the field to cultivate the crops. In addition, the global population is increasing year on year, leading to increased demand: a trend that is unlikely to abate. Our softs trader predicts areas of innovation such as edible insects as a means to satisfy the additional protein requirements of a growing population.

To what extent is the hype linked to the tech revolution and/or environmental issues?

SS's view is that while technology would affect prices for rare earth metals and rare metal alloys, which are commonly used in fuel cell technology, consumer electronics, medical devices and defence systems, the picture may be somewhat different for other raw materials. As technology improves, raw materials can be used more efficiently, giving you more "bang for your buck" and resulting in a drop in demand. Similarly, as the price of one raw material goes up, the markets will find alternatives. An example of this is the use of aluminium power cables as a substitute for copper when the price of copper is too high; aluminium core, steel reinforced (ACSR) being an effective price and weight substitute for copper. In other words, there is a marked based price-capping effect. The longer that sustained high prices persist, concludes SS, the greater the move to substitution. Like oil, where high oil prices helped accelerate the move to hybrid and electric cars (which incidentally use more copper …).

On the environmental side, for agricultural commodities, extremes of temperature that are increasingly prevalent mean that crops are more susceptible to potential failures and shortages of supply, again driving prices up. As for "green technology", SS points out that it would tend to mitigate against demand for fossil fuels and some metals.

If there was to be a supercycle, would it be across all commodities classes?

From the demand side, our softs trader used as an example the loss of a third of pig livestock in China caused by the outbreak of African swine fever in 2019/20. As the world's biggest buyer of soft commodities, China restocking that pig shortage is likely to lead to a surge in demand for feed (e.g. corn, soybeans) but only temporarily.

However, SS cautions that expectations that China will pay above market value for commodities, feedstocks or otherwise, should be tempered. A policy paper has been recently released making clear that it will not be buying as much metal as had previously been anticipated, as processing costs are becoming too high. As a result, any anticipated price rises are unlikely to be as substantial or long term as some have predicted.

What other trends can we expect to see?

Both our traders agree that as the world recovers from the pandemic, and demand and supply even out after a year of stop/start production and trading, we are likely to see a series of small bubbles in the short to medium-term. However, these will be caused by temporary phenomena and are unlikely to lead to a sustained rise in prices and therefore a true supercycle.

Their view is that, while prices are on the higher side, we may see an increase in investment in the production and distribution of commodities. Although the capital requirement is higher, the expense can be justified by virtue of the price of the end product.

Although ways of transacting are certainly changing, our experts caution that taking this as a knee-jerk reaction to the pandemic and/or a sign of an impending supercycle is a misunderstanding of the economic forces at work. The global economy has been transforming for some time and the transition is better viewed as an evolution of tastes, rather than a wholesale adjustment in the demand for and supply of commodities across all classes.

Conclusion

While corners of the internet would have you believe that COVID-19 has seen a world shift that is likely to be matched by a radical change in mindset and, by extension, the demand and supply of commodities, those with day-to-day involvement see a different picture.

What is clear is that the disruption of 2020 is far from over, and therefore the question is how each part of the industry adapts and progresses in the light of the challenges faced.

With huge thanks to our contributing traders, not least for allowing us a moment to step away from the legal implications to discuss the practicalities facing many of our clients every day.

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