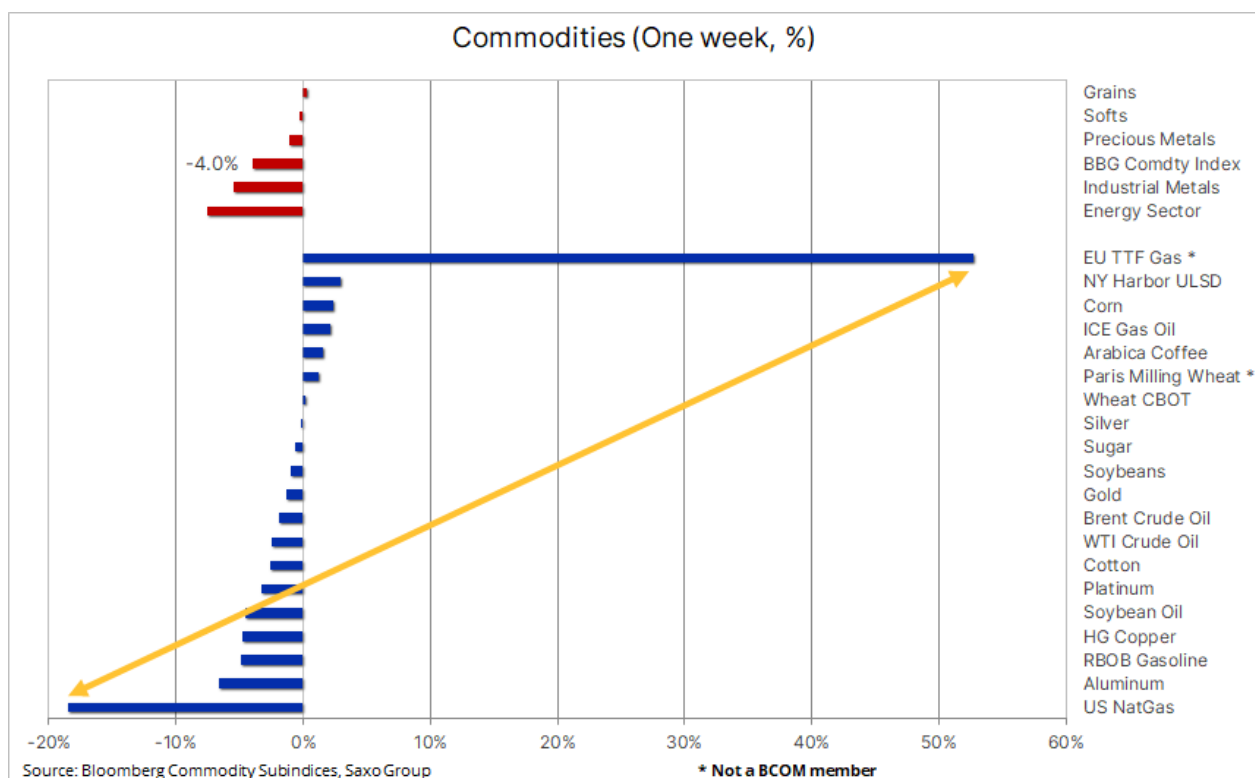


WCU: Commodities drop as inflation battle heats up

By Ole S. Hansen // June 17, 2022

Central banks took centre stage this past week after they announced rate hikes in an ongoing effort to curb runaway inflation. The 75-basis point rate hike – and promises of more to follow – announced by the FOMC on Wednesday, added to an ongoing rout in global stocks and bonds. In fact, global equities were headed for their steepest weekly decline in two years after the SNB (Swiss National Bank) and BoE (Bank of England) joined in, thereby adding to concerns that tighter monetary policies could undermine the post-Covid global economic recovery.

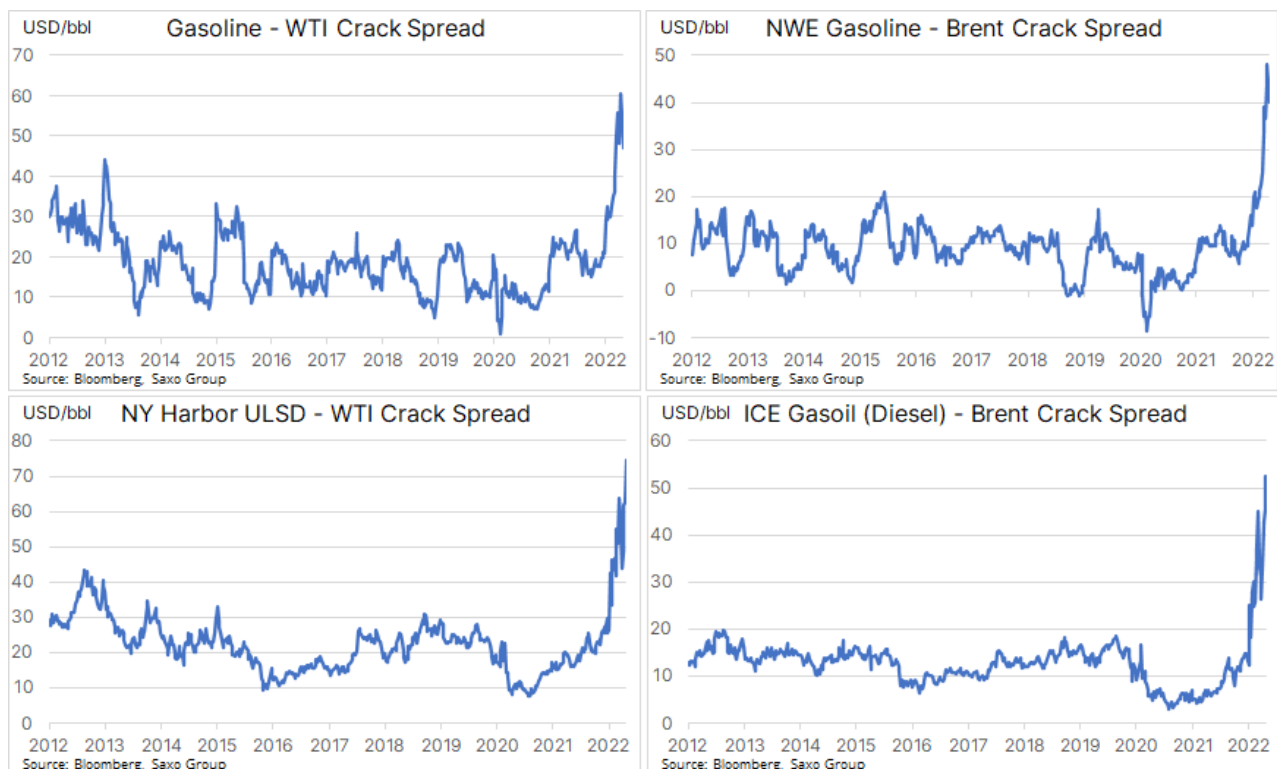
The recent price actions and changes seen in bonds and stocks have gone straight to the history books. An example being the S&P 500 which, in five out of the last seven trading days, has seen more than 90% of its stocks decline. Since 1928, we have not seen such an overwhelming display of selling. Together with the rout in Cryptos and blockchains, this was indeed a week where investors had trouble finding a haven, with some commodities being the exception.



Global growth worries helped push the Bloomberg Commodity index to its biggest weekly loss in three months, with all sectors (apart from grains) suffering setbacks. The most notable decline was seen in the energy sector after a prolonged outage at a major LNG (Liquid Natural Gas) plant triggered a selloff in US natural gas, with more being available for domestic consumption. Inadvertently, the disruption in US gas supplies to Europe and Russia turning down the taps to Germany and Italy, saw European gas prices jump by more than 50%. A development which, together with already record high prices for diesel and gasoline, once

again highlight Europe as the epicentre of growth concerns – mostly stemming from Russia's war in Ukraine.

Meanwhile, crude oil and fuel products refused to be dragged into the narrative of lower growth – leading to lower demand and lower prices. The current level of market tightness driven by supply issues is simply too big of a factor to ignore. As a result, we are seeing low availability of fuels into the peak summer demand season. Along with this, we are seeing a continued surge in the margins refineries earn from their production of fuels, especially diesel – the fuel that keeps the world and economies on the move.



Being such an important input to the global economy, a small weekly loss amid rising growth fears from aggressive central bank rate hikes highlights the current predicament of tight supplies, driven by years of lower investments. These have been caused by historically bad returns, high volatility and uncertainty about future demand, ESG (Environmental, Social, Governance) and the green transformation. Several OPEC+ members, for various reasons, included those mentioned are close to being maxed out. With spare capacity being increasingly concentrated among a few Middle East producers, the prospect for a continued rise in demand over the coming years will be challenging.

Sanctions against Russia and other multiple disruptions have led to the OPEC+ group trailing its own production target by more than 2.5 million barrels per day. The risk of even tighter markets was highlighted by the IEA (International Energy Agency) in their monthly update when it said that world oil supply will struggle to meet demand in 2023. A post-Covid resurgent Chinese economy and tighter sanctions on Russia being the main reasons and, despite emerging growth clouds, the Paris-based agency still expect demand to accelerate by 2.2 million barrels per day

to 101.6 million barrels per day, only 0.3 million barrels per day above a recent forecast from the US Energy Information Administration.

Following several failed attempts to break resistance in the \$125 per barrel area, Brent instead went looking for support at lower prices. However, once again, the setback proved very shallow, with support being found ahead of \$115 – a previous resistance-turned-support level.

Industrial metals suffered a fresh setback as the Bloomberg Industrial Metal Spot Index hit a fresh low for the year – down 28.5% since the March record peak. The peak came just before Covid-19 outbreaks in China (the world's top consumer of metals) helped trigger a sharp reversal. Between May and early June, the index went through a small recovery phase as China began lifting Covid-related restrictions, thereby boosting the prospect for growth initiatives. However, renewed lockdowns in Shanghai, the prospect of restrictions potentially not being lifted until next year as well as renewed focus on a central bank-driven global growth reversal helped send the sector sharply lower this week.

Aluminium dropped to an 11-month low after US data stoked recession fears. This was while copper drifted lower towards key support in the \$4 per pound (\$8900 per tons) area, thereby setting up the potential for a challenge at a level from where prices have bounced on several occasions during the past fifteen months. As long as inventory levels in exchange monitored warehouses continue to fall, as opposed to rising given the current softness, we maintain our long held bullish view on the direction of the sector.

A break in copper below the mentioned levels may trigger a temporary downward push which, in our opinion and using Fibonacci's retracement numbers, could trigger a downward extension to \$3.86 or in a worst-case scenario drop of around 12% to \$3.50.



Source: Saxo Group

Precious metals: Gold and silver traded lower this week but well above levels that otherwise could be expected, given the adverse movements seen across other markets – most notably the dollar and US treasury yields both rising in response to the FOMC 75 basis point rate hike. However, as we highlighted in our most recent [update](#) gold has increasingly been showing signs of disconnecting from its normal strong inverse correlation with US real yields. Based on ten-year real yields at 0.65%, up from –1% at the beginning of the year, some will argue that gold trades too expensive by around 300 dollars.

While rising dollar and yields in recent weeks have acted as a drag on gold, thereby raising discussions about its inflation hedging credentials, it is safe to say that other supporting drivers are currently at play. The most important being the risk of current central bank actions driving a hard landing, meaning that a US recession could emerge before inflation is being brought under control – thereby creating a period of stagflation, periods which historically has been bullish for gold.

We believe that hedges in gold against the rising risk of stagflation, traders responding to the highest level of inflation in 40 years and turmoil in stocks and cryptos are some of the reasons why gold has not fallen at the pace dictated by rising real yields. With that in mind, we are watching what investors do (not what they are saying) through the ETF (Exchange Traded Fund) flows. During the past week, total holdings in bullion-backed ETFs have seen a small decline of less than 0.25% – again, a development highlighting investor maintaining exposure to offset the tumultuous conditions seen across other markets and sectors.

Our long held bullish view on gold and silver has been strengthened by developments this past week. We still see the potential for gold hitting a fresh record high during the second half, as growth slows and inflation continues to remain elevated. The weekly chart shows that if \$1,780 support is broken, there is no strong support before around \$1,670 while a daily close above \$1,880 is needed to change the current rangebound market behavior.



Source: Saxo Group



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