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MACRO MORNING BRIEFING

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The Commodities Super Squeeze Of 2024

The rally in commodities – dominated by the reversal higher in energy prices – has been a standout feature in markets so far in 2024. This could be described as a 'super squeeze', quite a turnaround from last year, when Energy and Utilities were the worst performers. Geopolitics gets blamed for surging energy prices. Adverse weather and natural disasters have contributed otherwise. However, some of the pain is self-inflicted from last year – the lack of investment in critical metals, minerals and materials needed for the energy transition has exacerbated the situation.

Some highlights in the agricultural space: cocoa prices soar to their highest level in 46 years, then extend to a new all-time high; Robusta coffee prices have climbed to their highest level in 16 years; sugar prices have rallied to a decade high – racking up a stunning gain of over 450% from the 2020 low. Elsewhere, uranium's bull market is off to a red-hot start in 2024, with spot prices rocketing above $106 per pound to hit their highest level in 17 years. That's more than a 100% increase from the 2023 low – and a whopping gain of more than 350% from the 2020 low.

- Oil as a barometer of global growth and recovery, particularly in China and the EU, is part of the dynamic. Energy M&A last year approached record levels ~$350bn – many expect even more in 2024. Prices have been on an absolute tear. Both the Brent and WTI crude benchmarks have been up nearly $10/bbl, or 12%, this month, hitting their highs for this year.
- Gold has a special place in markets – many view it as an alternative to hard currencies. Record highs mainly owe to concerns around government debt levels and inflation, as well as to doubts about fiat currencies. We defer to ex-Fed Chair Alan Greenspan, who said this in 2014 at the Council of Foreign Relations: "Gold is a currency. It is still, by all evidence, a premier currency, where no fiat currency, including the dollar, can match it."

- The net of commodity moves in 2024 leaves the S&P/GSCI index up 12% year-to-date, led by oil and dragged down a bit by natural gas. Food has also been a key concern. Many are worried about how the next quarter plays out with hunger issues a risk in various parts of a world that, overall, is also troubled by climate change and geopolitical tensions.
- Back in January, 'super squeeze' fears for commodities were commonplace and left many worried about inflation in goods following. Sticky inflation in developed markets continues, but goods inflation has not been notable, while currency fears have been more dominant, particularly in emerging markets. Geopolitics has led much of the news driving commodities, particularly the Houthi actions in the Red Sea. There are also ongoing fears about the US dollar being 'weaponized', with China and other EM central banks diversifying USD reserves to the yellow metal cited as a key factor.

When you look at the correlation of commodities to commodity currencies and to stocks and bonds, inflation fears appear overblown. The relationship of commodities to US 10y yields seems better explained by shifting expectations for Fed rate cuts, rising risk premiums and ongoing US fiscal/political doubts, along with borrowing across the world as modest recoveries follow soft patches and recessions in 2023. What stands out in FX is how CAD and NOK are more correlated to commodity risks than AUD or ZAR. Further, the link of EM bonds to commodities is modest – sure, oil, gold and copper matter, but not as much as stocks or FX rates to the USD.

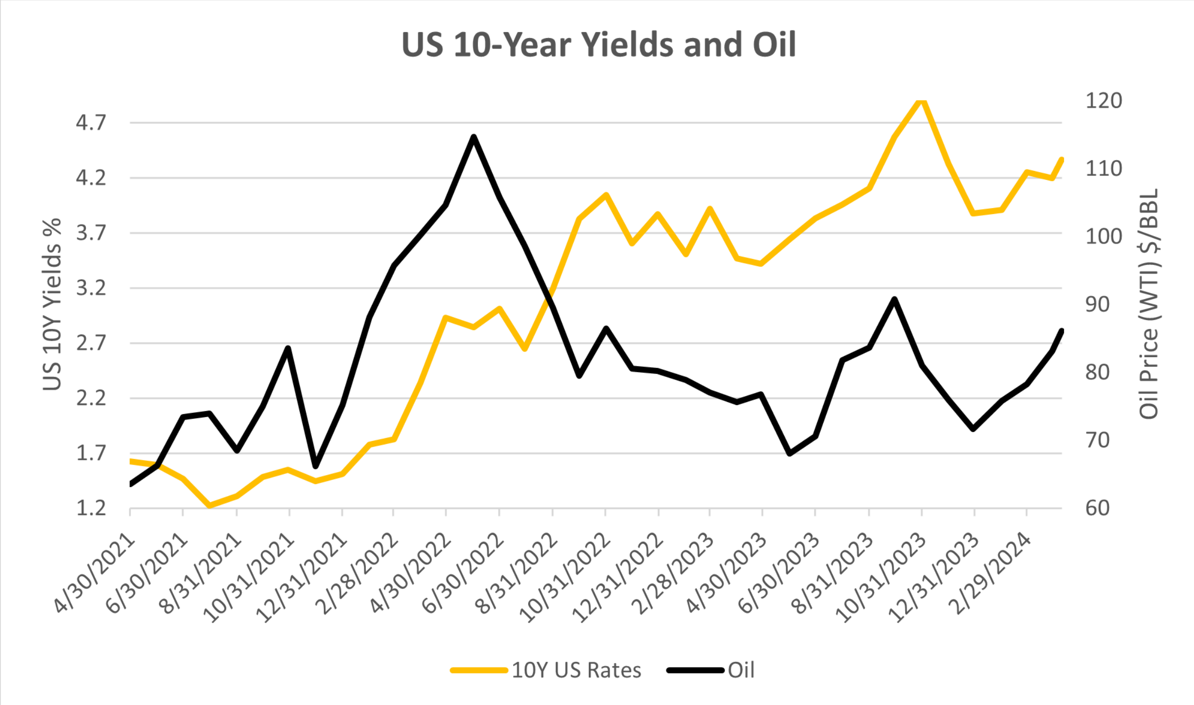
Exhibit #1: Correlations Of Commodities To USD, Bonds And Stocks

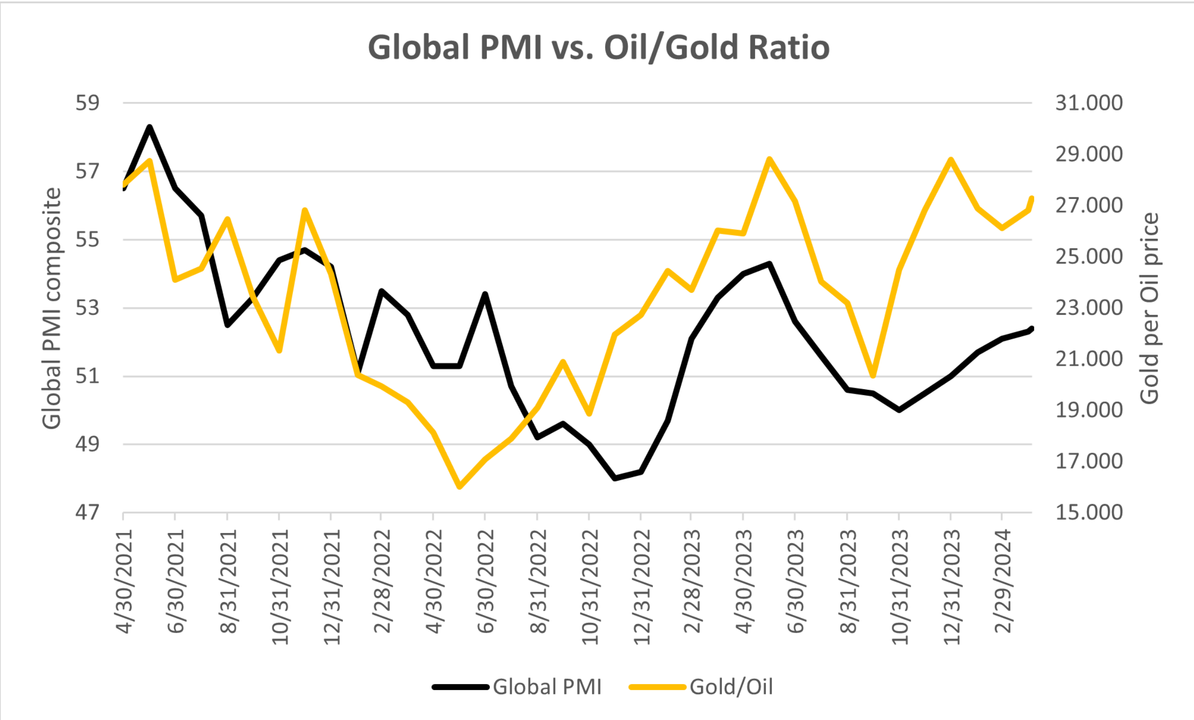
Monthly Correlation 2012-2024												
Security	EMBI	USD index	GSCI tot ret	Oil	AUD	CAD	NOK	S&P 500 INI	Gold	Copper	ZAR	10Y US
EMBI Index	1	-0.527	0.327	0.351	**0.626**	**-0.637**	**0.637**	**0.636**	0.349	0.36	**0.631**	-0.258
USD Index	**-0.627**	1	-0.327	-0.268	**-0.677**	**0.706**	**-0.748**	-0.405	-0.442	-0.497	**-0.623**	0.107
S&P GSCI Tot Return Indx	0.327	-0.327	1	**0.877**	0.404	-0.548	**0.681**	0.409	0.088	0.497	0.407	0.428
Oil	0.351	-0.268	**0.877**	1	0.322	-0.444	**0.626**	0.361	0.038	0.371	0.338	0.327
AUD	**0.626**	**-0.677**	0.404	0.322	1	**-0.756**	**0.737**	**0.584**	0.36	**0.573**	**0.636**	-0.019
CAD	**-0.637**	**0.706**	**-0.548**	-0.444	-0.755	1	**-0.741**	**-0.686**	-0.276	**-0.683**	**-0.682**	-0.124
NOK	**0.637**	**-0.748**	**0.681**	**0.626**	0.737	**-0.741**	1	**0.674**	0.296	**0.62**	**0.687**	0.075
S&P 500 INDEX	**0.636**	-0.405	0.409	0.361	0.584	**-0.686**	**0.674**	1	0.114	0.474	0.394	0.074
Gold	0.349	-0.442	0.088	0.038	0.36	-0.276	0.296	0.114	1	0.257	0.287	-0.342
Copper	0.36	-0.497	0.497	0.371	0.573	**-0.683**	**0.62**	0.474	0.257	1	0.448	0.236
ZAR	**0.631**	**-0.623**	0.407	0.338	0.636	**-0.682**	**0.687**	0.394	0.287	0.448	1	0.078
US 10Y Yields	-0.258	0.107	0.428	0.327	-0.019	-0.124	0.075	0.074	-0.342	0.236	0.078	1

Source: Bloomberg, BNY Mellon

Higher oil prices have been a key driver of many doubting the Fed's rate-cut plans in 2024, as is evident in market pricing downshifting from six cuts to two. The risk of inflation going up linked to oil prices connects to the recovery hopes for China and Europe. The global PMI bounce since October and the rise in the gold/oil ratio is worth considering. Just as central banks seem set on cutting rates, goods inflation returns to the fore, leaving a tough balance between gold going up in tandem with oil. Gold is up 14% compared to the 19% rise in WTI crude, but still well below the politically more important gasoline price, which is up 31% year-to-date. The history of gold or oil as a benchmark commodity and alternative to fiat currencies should be noted as well – with the risk of USD debasement part of the geopolitical fears in the 2024 commodity cycle. Resolution of either the Russia-Ukraine or Israel-Hamas conflicts will likely be a shock to current prices across markets.

Exhibit #2: Oil & Gold Matter But Not Enough To Shift Fed

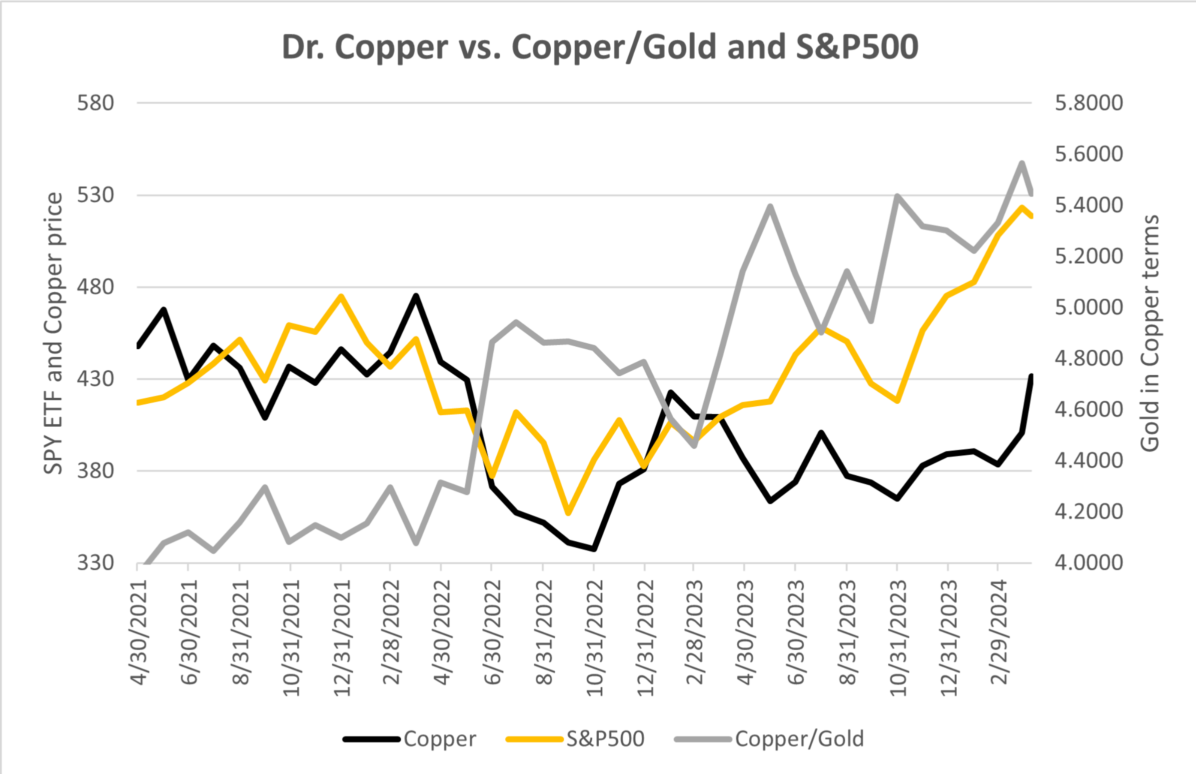




Source: Bloomberg, BNY Mellon

The other part of the commodity story has been in Green technology and chip demand driven by AI investments. The need for copper has been a standout. That the red metal is up 10% on the year does reflect this story well, but the correlation of copper alone is not as powerful in tracking global stock markets as is the relationship of copper to gold. The weakness of fiat currency – linked to doubts about central bank credibility and governments' fiscal policy – drives asset inflation across markets, which in turn gets reflected in higher gold prices. Most stock markets are not correlated to gold alone, but in conjunction with copper and its industrial demand it becomes a well-researched and viable trading signal for risk.

Exhibit #3: Copper Matters But Gold/Copper Even More

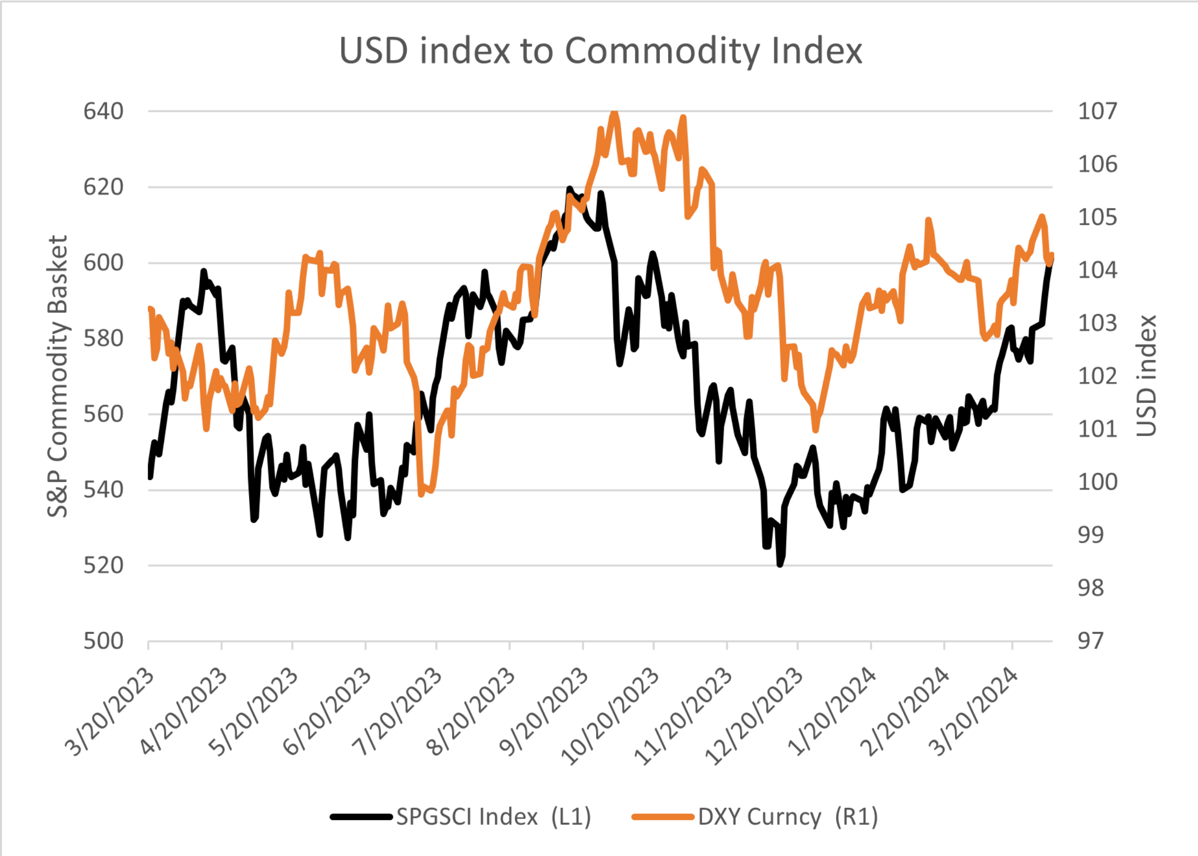


Source: Bloomberg, BNY Mellon

The role of the USD in commodities is complicated, as the US has shifted from dependence on foreign oil in the 1970s to being an oil exporter today. The US as the largest oil producer, along with one of the biggest users, makes its role less important. But other commodities still matter and the relationship of the commodity index to the USD index is still negative. However, the track of the USD to commodities is more linked to economic cycle expectations and the rate policies that follow from them. Oil fell on the US banking wobbles last March but the USD held, and the ensuing oil rally on global demand coincided with ongoing Fed rate hikes.

Markets are back to a negative correlation view, where higher energy and other commodity prices may sap consumer demand and crush the economy as it leaves the FOMC stuck high for longer. Recession fears vs. inflation fears are clearly connecting in the commodity cycle for 2024. When we look at iFlow and equities, the inflation factors are not in play – indeed, down sharply from Q4 2023. When we look at the commodity currency complex, investors are long but losing money with positions in CAD and NOK notable against shorts in AUD.

Exhibit #4: USD Negatively Correlated To S&P GSCI



Source: Bloomberg, BNY Mellon

Bottom Line: The runup in commodity prices this year is surely one of the many factors on the Fed's radar. But for the fears of a resurgence in inflation to be realized, it will likely require something larger than the gasoline spike. After all, higher gasoline prices also act as a tax of sorts on consumers, hampering their spending along with souring their moods. The cost-of-living shocks from energy may derail growth outlooks later this year, as well as keep inflation-related headlines less friendly to easing policy. The key focus, however, is on other credibility functions linked to gold. Those are more about geopolitics, how the US and China resolve their disagreements, and whether global growth proves sustainable.

Disclaimer & Disclosures

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