

Commodity Supercycle: Real or Hype?

Concerns that the surge in global commodity prices will trigger inflation in many emerging markets, especially food-importing countries, have recently been building. All commodity indices have been on a rally since late Q2 2020. S&P GSCI Agricultural Index, for instance, recently hit its highest level since 2014 (+36% since August 2020), while prices are rising at their fastest pace on an annual basis since 2011. This raises a few questions. **First**, are we in the beginning of another supercycle or already in the middle of one? **Second**, how have the commodity dynamics rapidly changed to trigger such a cycle despite the effect of pandemic-related distortions on potential GDP? **Third**, how will these pressures disrupt the inflation outlook, especially in EMs, such as Egypt?

First, we have to remember that the upturn phase of the commodity supercycle results from a gap between unexpected and persistent demand drivers and slower-moving supply factors. This produces “decades-long, above-trend movements in a wide range of base material prices,” the definition of a supercycle. Such a situation where prices are high eventually drives supply to increase and demand to slow, after which the cycle enters a downturn phase. Recently, global commodity demand received a boost from (1) faster-than-expected recovery in China’s economic growth, (2) a positive upgrade in U.S. growth outlook, thanks to unprecedented quantitative easing and a generous fiscal stimulus, (3) less restrictive lockdown measures, and the first phase of the vaccine rollout around the world, and (4) the new green industrial revolution which triggers a wider demand for all sources of clean energy.

However, not all of these dynamics are sustainable enough to create a rosy outlook for commodities, given that each commodity group has its own price drivers. For instance, oil prices that have recently risen to their highest level in 13 months garnered much of their support from a single action by Saudi Arabia which cut 1mn barrel/day of its production voluntarily in February and March, coupled with hopes for demand recovery as the vaccination process accelerates. Yet, the recent surge in oil prices will put heavier pressure on many OPEC+ members and more so on African countries, jeopardizing their commitment to the output-cut deal. Moreover, Saudi Arabia will likely resupply the 1mn barrel/day after March.

Still on the horizon are less supportive drivers for commodity, including (1) less dovish Fed due to mounting inflation risks that could lead the Fed to start tapering asset purchases earlier than expected and (2) a higher U.S. yield and dollar rebound. These factors would deteriorate the outlook for gold, which in our view has already reached its peak. Cyclical commodities, like copper and aluminum, still have a positive outlook as their growth prospect is gaining momentum, while the strong positive sentiment for other commodities, like steel and iron ore, is still gaining steam from the recovery in the Chinese auto industry and higher Chinese government spending in infrastructure and construction. Furthermore, demand for clean energy should support the long-term outlook for clean energy sources. Meanwhile, we see pressures on global food prices easing. But even if food prices do not ease, the latest wave of local currency appreciation in EMs, such as Egypt, against the U.S. dollar should weaken the effect of accelerating commodity prices on domestic inflation.

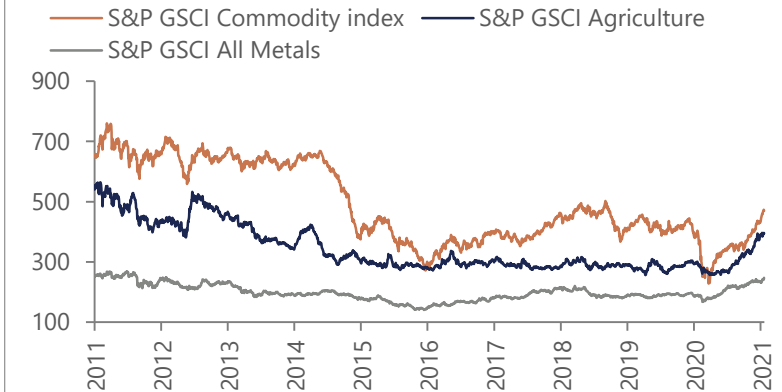
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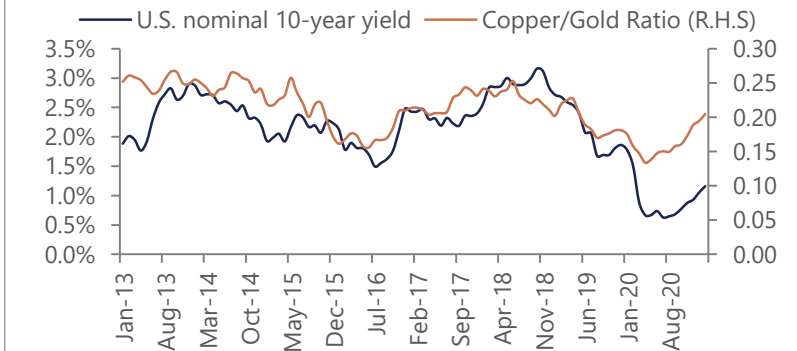
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Figure 1: Commodity prices have been on the rise since late Q2 2020; Agri. Index hits its strongest level since 2014



Source: S&P.

Figure 2: Copper/gold ratio suggests a further rally in U.S. yields in view of a faster-than-expected global recovery



Source: Bloomberg, Prime Research.

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