2020: COVID-19, commodities and change

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The past year has been unlike any other in modern economic history. It began positively, with a strong growth trend supported by a cessation in the trade war that had plagued the global economy for much of the previous 18 months. The US Federal Reserve, the People's Bank of China and the European Central Bank were all cutting rates, creating accommodative monetary conditions for growth. Major sentiment and momentum indicators were picking up steam and equity markets were rallying strongly after a summer lull in 2019. Commodity prices followed suit. At the start of our financial year in early October 2019, Brent was at its second-lowest level of the year at USD56 per barrel, before moving upwards in a nearly straight line to touch USD72 per barrel in early January 2020. Copper did the same, touching USD5,600 per tonne in early October before moving upwards more or less continuously to USD6,300 per tonne in early January 2020. Zinc and aluminium also largely followed the same trajectory. Indeed, from the start of our financial year to early January 2020, most classes of risk assets had moved up by anywhere between five percent (non-USD FX) and nearly 30 percent (Brent).

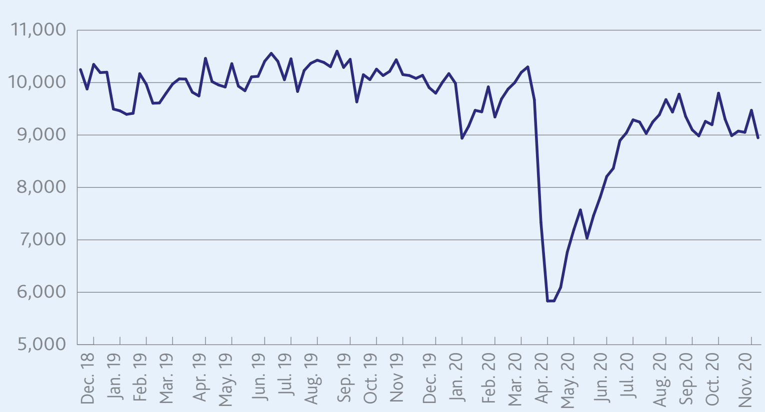
But that was before COVID-19 and the unprecedented hard stop it inflicted on global economic activity.

Whereas previous economic slowdowns or periods of turbulence were caused by weaker demand leading to a contraction of economic activity, in 2020 it was the inverse: a forced halt in economic activity implemented in quick succession across the world's major markets led to a shortfall in demand. Global air travel, which accounts for approximately 10 percent of global oil demand, fell to practically zero for a period of time, and by November 2020 had still only recovered to circa 40 percent of previous levels. US gasoline demand, which typically represents a further 10 percent of global oil demand, halved and remains over one million barrels per day below previous years' average levels. The reduction in global trade and manufacturing impacted gasoil demand. However, the fact that construction was deemed strategic, and therefore escaped the brunt of lockdowns, helped mitigate a steeper decline in demand for this fuel.

Normally, a reduction in demand of even a fraction of this magnitude would have elicited a rapid cut in production by OPEC members and associated producers. In 2020, however, disagreements among the OPEC+ group's members led to a temporary abandonment of quotas in lieu of an all-out battle for market share. The timing of the decision to do so coincided with the start of China's recovery from the impact of COVID-19, but before full realisation that the rest of the world would soon be in a situation similar to what China had just been through. The subsequent OPEC+ decision to reverse the March decision to raise output and instead cut output a month later was too little too late, and caused close to one billion barrels of excess inventories to accumulate over a very short period of time.

US Gasoline Demand

Total Output Implied Demand
Units: 1000 barrels per day (or kbd)

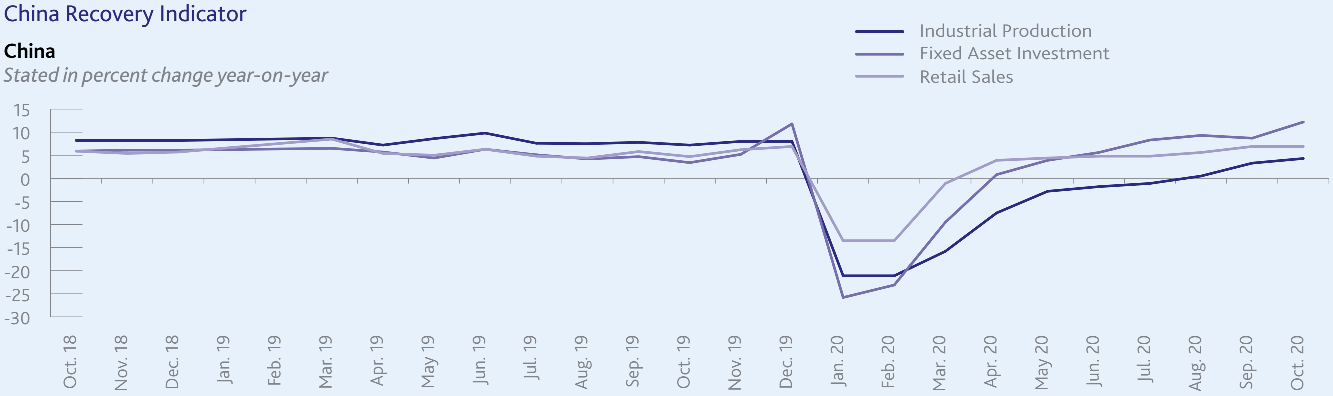


Source: US Department of Energy

China Recovery Indicator

China

Stated in percent change year-on-year



Source: China National Bureau of Statistics

As a result of producers ramping supply to never-before-seen levels at the same time that an unprecedented reduction in demand was unfolding, crude oil prices suffered significant losses. Indeed, a combination of production levels that were just beginning to come off, a massive drop in demand, and a lack of available physical storage at Cushing, the critical physical delivery point for WTI oil, briefly resulted in negative WTI price for the first time in history.

That was the situation for oil in April. But for over a month by that point, other parts of global markets were already moving higher. Much of this was due to the fact that although China was the first to experience the COVID-19 outbreak, it was also the quickest to react and the quickest to recover. The initial stringent lockdown measures in China allowed for a quick restart of activity only a couple of weeks after the end of Chinese New Year, which is normally a slow period for China in any case. This rebound was more of a supply-led one, as increased liquidity and credit meant that investment and manufacturing started back up quickly. End-use consumer demand was slower to recover initially, but picked up steam mid-year. With manufacturing, construction, investment and consumption all back on track, China is the only major economy that will record year-on-year growth for the calendar year as a whole.

Metals prices have certainly benefited strongly as a result of China's recovery, with copper rising to a two-year high and looking set to continue rising as construction, infrastructure, electrification and the roll out of 5G technology all contribute to strong demand growth. Zinc and aluminium prices have also hit multi-year highs as the global auto sector has remained an area of consumption strength, albeit after an initial drop-off during the height of the pandemic. Nickel has not quite hit the highs of 2019, but is benefitting from the increasing adoption of electric vehicles globally, and again looks set to see demand growth into the future.

Oil prices continue to be impacted and are down approximately 40 percent compared with their 2020 peak, while almost every other asset class has exceeded their year-to-date highs and in many cases reached multi-year highs. Since April, the market has seen a multi-speed recovery. China not only rebounded quickly, it is now seeing material growth over 2019's refinery runs; India's rebound took much longer, but it too is seeing some early signs of growth. However, European runs remain significantly lower versus 2019, and the US has proven the real global laggard, pointing to a tricky road ahead for the market.

Looking ahead, there are significant uncertainties that remain to be resolved for the market. The widespread deployment of an effective virus vaccine will go a long way towards helping demand and economic activity recover to previous levels, but there are long-term questions around the amount of debt that countries have taken on while dealing with the crisis. For the US, that could mean the start of a weaker US dollar cycle, which in turn should boost global growth and commodity prices, but the market will need to absorb an unprecedented amount of new debt without sending rates to levels that would hamper growth.

Longer term, two long-standing and inter-related challenges remain: the accelerating energy transition and reversing the systemic and enduring under-investment in the value chain needed to make the energy transition happen. Governments over the world are adopting more ambitious emissions reduction targets, hastening the build out of renewable power generation, expanding electrical grids, and encouraging electric vehicle adoption. The energy transition will require significantly more copper, nickel and other metals, and so far investment in these areas has been lagging behind future projected needs.

How the world deals with the overlapping issues of the COVID-19 pandemic, debt, climate change and resource investment will drive the market for the next year and beyond.

Copper price data 2015 - 2020

Trade close

Units: USD per tonne