WEEKLY ANALYSIS

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COMMODITIES: IMBALANCES WILL PERSIST IN 2023

180 degree turn by the Chinese government. Total opening of the country. Growth to resume in 2023. Energy sector supported by Asia. Historically low metal stocks and potential demand increases in 2023. High potential for appreciation in metal prices in the coming year.

Key points

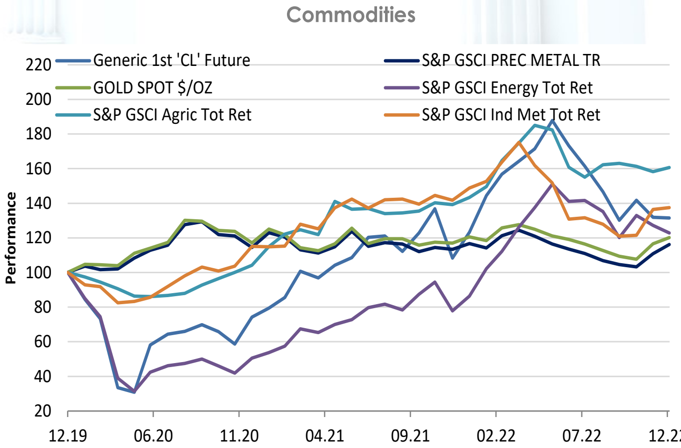
- End of China's zero Covid policy upsets forecasts
- Oil demand driven by Asia
- Low crude oil production in 2023
- Overall low metal inventories
- Industrial metals in supply deficit
- Macroeconomic environment finally favourable to gold?
- New record highs for precious metal prices?

End of China's zero Covid policy upsets forecasts

The end of China's zero Covid policy will bring new hope and opportunities for the commodities sector. A recovery in consumption and investment demand from the world's largest importer of raw materials should have a major impact on the supply and demand balances of a large number of specific commodities.

The decision by the Chinese authorities to end the policy of strict control of the evolution of the Covid pandemic in China, which has prevailed for several years, will have a significant impact on the global market, particularly affected in 2022 by a sharp drop in Chinese demand. The speed with which health measures have been abandoned is spectacular. China has gone from a zero Covid policy to a strategy of total openness, allowing a new freedom of movement and travel within China, but also abroad. The first effects of this opening up are catastrophic in terms of the health of the population, but the authorities seemed to have no other option and therefore accepted the likely consequences of this change in strategy. After an initial massive wave of Covid that could still affect China's economic dynamics, the authorities are counting on a clear upturn in activity which, according to them, will enable GDP growth in 2023 to be significantly higher, close to +5%. The year 2023 should thus prove to be much better than 2022, which certainly saw GDP advance by only around +3%. The first quarter could still be a little weaker, but the effects of the new policy will probably be more visible from the spring onwards.

In 2022, commodity markets were essentially affected by two very different sequences. In the first quarter, Russia's invasion of Ukraine completely disrupted global supply and demand forecasts and expectations. An immediate price surge occurred in response to the perceived sustained disruptions in the production and supply of certain commodities produced by Russia and Ukraine. Secondly, it was the risks of a cyclical slowdown, caused by the aggressive monetary tightening by developed country central banks such as the Fed, the ECB and the BoE from March onwards, which led to fears of a clear slowdown in the economic dynamic in Europe, while China, which was already very concerned by the evolution of Covid in the country, was implementing a severe health policy that was penalising its economic development.



Sources: Bloomberg, BBGI Group SA

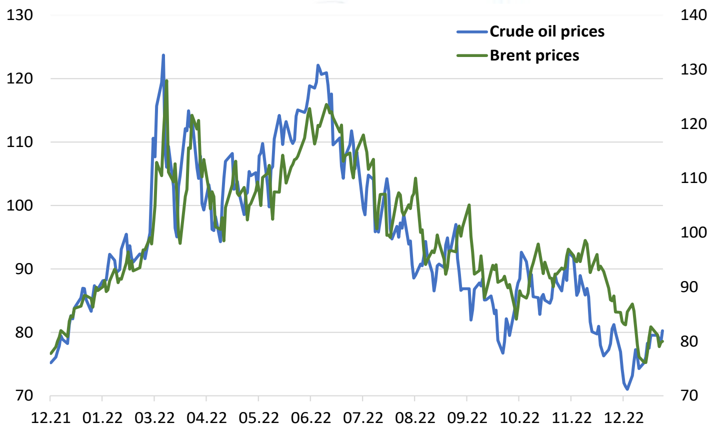
In this context, the Bloomberg Commodity Index jumped by 25.4% in the first quarter before falling by 5.9% and then by 4.7% in the following quarters, before recovering slightly in the last quarter by +1.1%.

The Chinese government has surprised observers and forecasters by making this radical change in health policy, which necessarily opens up completely new and unanticipated perspectives in 2023.

All demand forecasts will have to be adjusted to take this new parameter into account. Clearly, a recovery in Chinese activity is by far not included in the analysis and outlook for the year 2023.

However, it should be noted that the recovery in China will not be instantaneous and will have more or less diluted effects over time on the various specific markets. In China itself, the coastal cities will certainly be affected more quickly than the inland regions, but the proximity of the Chinese New Year should be a positive factor from the beginning of 2023. The recovery over the year as a whole will therefore be gradual and also partly dependent on the various government support measures that will be adopted to support economic activity.

Evolution of crude oil prices (2022)



Sources: Bloomberg, BBGI Group SA

Oil demand driven by Asia

We believe that the return to normalcy in China will have a very rapid effect on petrol and oil consumption due to the immediate increase in population movements. It is already apparent that traffic in China has already picked up strongly in December, although it is still below the level of January 2021. Air travel is also expected to return to pre-pandemic levels, representing a strong increase in aviation fuel demand.

We therefore estimate that oil consumption could return fairly quickly to its pre-pandemic level in 2023. More broadly, energy demand, including gas and coal but also all other forms of alternative energy, is expected to grow in 2023.

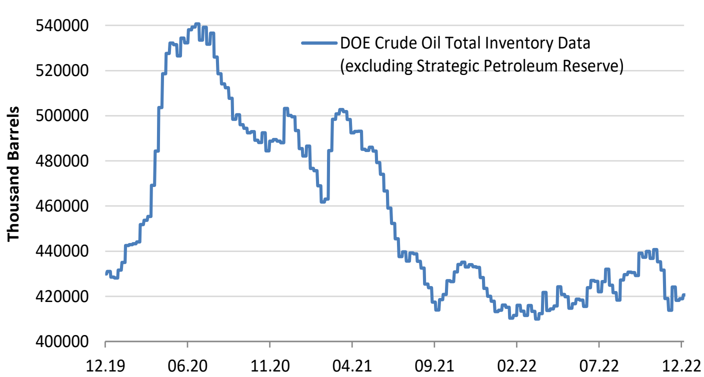
Oil demand could thus turn out to be stronger in 2023 and exceed the previous peak. The predicted economic slowdown in the US and Europe is expected to be limited, while demand from India and emerging markets is expected to rise more sharply. On the supply side, the EU embargo on Russian energy products will mean a downward adjustment of Russian supply. OPEC countries still have no intention of increasing production after years of declining capex.

The US is expected to be the only producer able to increase exports to meet the expected increase in global demand. Nevertheless, US shale oil producers should not rush to increase their production volumes and should certainly focus on improving their profitability.

In addition, OECD oil stocks are at their lowest level since 2004 and strategic reserves reduced in 2022 to increase supply and counter rising crude prices will need to be replenished in 2023.

We believe that this current global oil market environment is thus once again in even greater disequilibrium with the return of Chinese consumption. Our forecast for crude oil prices (WTI) favours a price increase above $100-110 per barrel.

DOE oil inventories

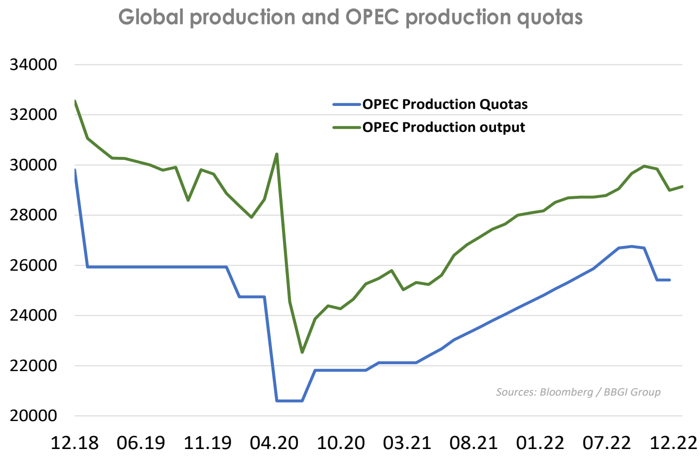


Sources: Bloomberg, BBGI Group SA

Industrial metals in supply deficit

Chinese demand, which had contracted compared to previous years due to health policy, was partially offset by the still strong demand from developed countries supported by the energy transition. Despite fairly positive supply and demand fundamentals, prices declined in the second half of the year due to a strong dollar and increased uncertainty due to aggressive central bank monetary policies. Overall, inventories of the various industrial metals are low at the end of 2022 despite the fact that changing geopolitical conditions still underline the need to secure access to metals such as copper, nickel or cobalt. In 2023, we believe that macroeconomic factors will continue to influence industrial metal prices with increasing risks of supply-demand imbalances.

The prospect of China's reopening has also supported renewed interest in industrial metals and iron in particular, despite the continuing difficulties in the property sector. Demand for steel should also follow that of iron, particularly if the authorities continue their policy of facilitating access to credit. China imports about 70% of its iron requirements for steel production, which in turn is about 40% directly linked to real estate consumption. An upward trend has been set in place that could push iron prices higher in 2023.

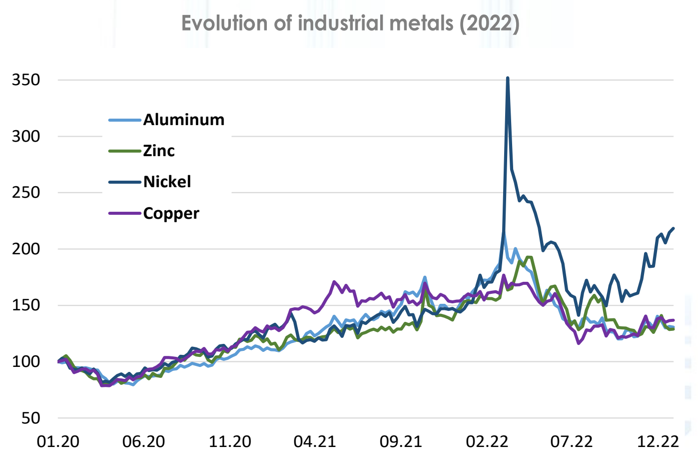


Sources: Bloomberg, BBGI Group SA

In 2022, demand for **copper** remained strong, supported in particular by infrastructure investment in Europe, but also in China due to electric vehicle production, which compensated for the decline in real estate activity. Copper is also essential to the real estate sector and to the development of renewable energies. A recovery in Chinese demand seems evident as copper inventories are falling.

On the international market, copper supply is tight, suggesting an imbalance and a probable shortage of supply in 2023 that could push prices up to the highs seen in 2022. The situation of the copper market is particularly tense, with world supply limited by the absence of additional production capacity and by a specific situation in Chile, while demand remains strongly growing and supported by policies for the development of renewable energies, the electrification of vehicles, batteries, photovoltaic cells, etc...

Copper prices could rise again to over $10,000 per metric ton.



Sources: Bloomberg, BBGI Group SA

Zinc stocks are also at record lows on the LME and Shanghai Futures Exchange. Demand was relatively weak in 2022, but production had fallen even more drastically to adjust to this decline. Rising gas and energy prices have had a strong impact on European processors. China, which is also a major consumer and importer of zinc, has also reduced its needs during the lock-in period.

The **aluminium** market had an extremely volatile start to the year 2022 with prices rising 60% on fears of falling supplies from Russia, which then quickly faded as the global economic outlook deteriorated.

The rise in energy prices in Europe affected aluminium transformation costs and caused the slowdown in activity. In China, the world's largest aluminium producer, processing has also been limited. Volatility is expected to continue in 2023.

The **nickel** market has also experienced strong fluctuations in 2022 and a distortion between physical and futures prices. Fundamentally, the market remains well-fed by increasing supply due to increased capacity in Indonesia in particular. If the country's development plans are realised, Indonesia could produce 50% of the world's supply by 2024. The market is therefore less tight and rather oversupplied unless demand for nickel batteries used in electric vehicles grows even faster under the impetus of the recovery in China.

Inventories of the six main industrial metals traded on the London Metal Exchange plunged by two-thirds in 2022 and are at their lowest levels in 25 years. The decline is 72% for aluminium, while zinc stocks are 90% lower, suggesting a possible shortage if demand proves a little stronger than estimated. Although the vast majority of metal production does not go through the exchanges, stocks on the LME or Shanghai Futures Exchange are important for estimating the risks and tensions in the physical markets between limited supply and, in particular in 2023, the potential new needs of China as its economy re-opens.

New record highs for precious metal prices ?

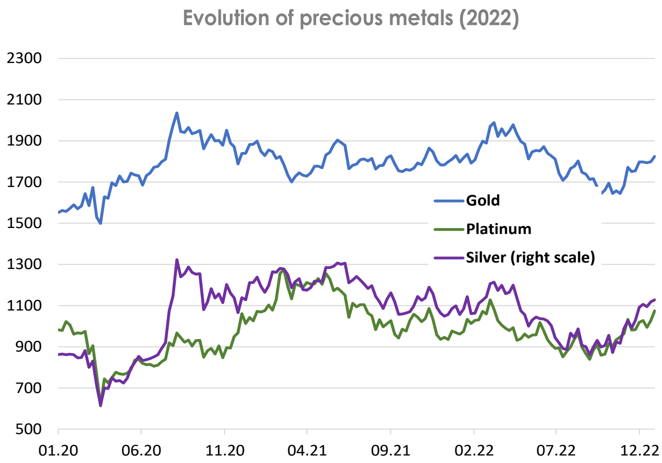
The year 2023 could once again be the year of gold and other precious metals. After being one of the best assets in 2022 in relative performance thanks to a performance close to zero but in fact far superior to all other traditional asset classes such as bonds and equities, gold could still shine with a significant positive absolute performance in 2023.

In general, the expected macroeconomic environment for 2023 is characterised by a change in central bank monetary policies after several quarters of restraint. The rise in policy rates should be accompanied by a global decline in yield curves, which will take place against a backdrop of weaker inflation data.

A weaker dollar will provide additional support to gold prices, which will then be in a position to set new records in 2023.

The observed activity of central banks in the physical market in 2022 reveals a new trend to diversify their reserves away from the US dollar through physical gold purchases. We expect the record of central bank buying to be repeated in 2023.

The World Gold Council has noted that the environment of economic weakness, and even recession in some regions in 2023, is a favourable context for gold, which has historically benefited in 5 out of 7 cases from US recessions since the 1970s. Moreover, it also appears that gold has always been an excellent asset to hold in times of stagflation.



Sources: Bloomberg, BBGI Group SA

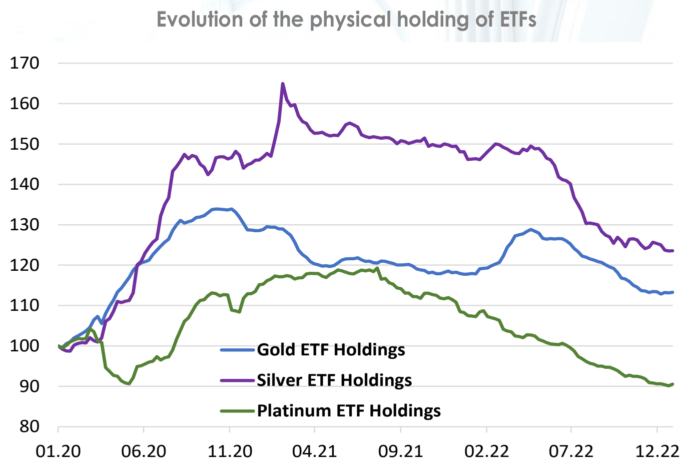
For silver, the Silver Institute estimates that global demand is expected to reach a new peak of 1.21 billion ounces already in 2022 and to strengthen in 2023, when the silver market will record another deficit year. In recent years, this deficit has been growing, but it is in 2022 that it has increased significantly. Demand is supported by the implications of silver in various stages of the energy transition. The main drivers of the demand recovery are also linked to the reopening of China which will support industrial demand. A rise in silver prices to $28.5 per ounce is in this context quite likely in 2023 according to our scenario.

Platinum ended the year up +11%, outperforming silver +3% and gold. Palladium was the only loser with a decline of -6%.

The World Platinum Investment Council stated in its latest report that the platinum market could well be in deficit by 2023 if the outlook for an increase of almost 20% in global demand materialises. Platinum supply, on the other hand, is estimated to increase moderately by +2% over the same period, which would put the platinum market into a supply deficit. After two years of surpluses, the market seems unlikely to rebalance and could therefore experience a year of production shortfalls.

Supply remains well below pre-pandemic levels, while demand for platinum is expected to remain strong even in the economic downturn expected in 2023. Demand from the automotive sector is strong again.

Investment demand contracted in 2022 for most of the year, stabilising only when gold prices rose at the end of the year. Investors' holdings of physical gold through Gold ETFs have fallen by -12% since April 2022 (-15.8% since 2020) and end the year at their lowest level in volume. The same phenomenon can be observed for Platinum EFTs, whose ounce size has fallen even more sharply by -24% since June 2021.



Sources: Bloomberg, BBGI Group SA

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