HSBC Global Research

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Commodity Economics Comment

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Upswing underway … at a new higher level

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Global commodity prices are in an upswing. We think they have passed the trough for the cycle. Demand appears to be lifting and the supply-side is 'super-squeezed'. HSBC's statistical model, COCCLES, shows an increased probability we are shifting from a 'Weak Bull' to a 'Super Bull' phase. And, this is all despite the fact that nominal commodity prices were high to start with. There is another factor to consider too. In 'real' terms – that is, relative to the US CPI – commodity prices are not that high – they are close to the historical average. That is, relative to the other goods and services you can buy, commodities have held their value. Given the general price level is unlikely to go back to its previous trend – it is now likely to be permanently higher – so too the current elevated nominal commodity prices may be a 'new normal'.

First up, the facts.

The Bloomberg spot price index for commodity prices (a nominal index that values commodities in USD terms) has risen by 11% year-to-date (Chart 1). The pick-up is fairly broad-based across commodities – including copper and most other metals (excluding iron ore), gold, cocoa and coffee. The trough in the index, in mid-February was 41% above its 2015-2019 average, and the index is now 60% above that average.

The commodity index appears to be in an upswing.

And, as we have noted before, we can see good reasons for this (see *Have commodity prices past the trough? It seems likely*, 11 April 2024). Demand indicators have started to pick-up as the global industrial cycle is turning more positive. Copper prices, which are often seen as a timely indicator of the industrial cycle, have picked up strongly (see *Dr Copper and the 'super-squeeze'*, 6 May 2024). The supply-side for commodity markets is constrained by persistent factors – including geopolitics, climate change and the energy transition – in what we have been calling a 'super-squeeze' (see *It's a super-squeeze*, 14 September 2022 and *Geopolitics and the super-squeeze*, 14 March 2024).

Our colleague, Duncan Toms, in the Multi-Asset Research team, has also noted in recent days that HSBC's statistical model, COCCLES, now suggests an increased probability that the commodity prices cycle is shifting from a 'Weak Bull' towards a 'Super-Bull phase (see *Turbo-charged: Multi-Asset Strategy*, 20 May 2024). Heady stuff.

The striking thing about the upswing in commodity prices, then, as Chart 1 shows, is that commodity prices were already high, but they are moving even higher!

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But are they really that high?

Maybe not.

Yes, they are high in nominal terms, but in real terms, they are around the historical average (Chart 2).

Breaking this down a bit further. By nominal terms, we mean USD terms (a standard benchmark). But the recent burst of high consumer price inflation has meant that US dollars now buy less goods and services than they used to. On the other hand, commodities buy as many other goods and services as they have done in the past on average.

This, of course, largely reflects the recent surge in CPI inflation.

Because we have not had high inflation for many decades, the effect is quite unfamiliar.

But here's the kicker.

Because central banks target inflation, not the price level, it seems unlikely that the price level will return back to down to its previous trend any time soon (Chart 3).

Commodity prices too, may therefore stay at a new higher nominal level.

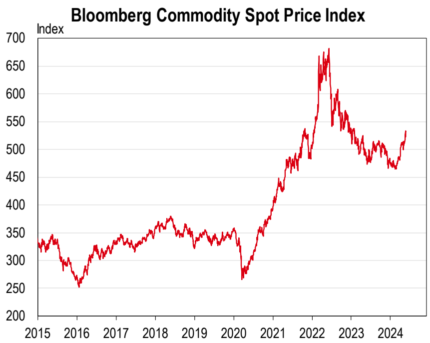
As an aside, gold prices have also risen to new all-time highs in nominal terms, and are also above average in real terms (Chart 4). Gold is, of course, seen as a store of value and a hedge against inflation – indeed, it is used for little else. As might be expected then, gold has been a stronger hedge against inflation than the broader commodities basket, with real gold prices above historical averages. That is, gold bullion buys you more goods and services than it has done in the past, on average – US dollars do not.

The key is that relative prices matter for understanding where commodity prices are and where they may be headed.

As we have pointed out for some time now, we expect nominal commodity prices to stay high, and that the forces at work are very different to those that drove the early 2000's China-demand-driven 'super-cycle'. The recent dynamics appear to primarily have been due to a supply squeeze. In addition, the general price level is now higher than it was – so commodity prices may also stay higher than they were as relative prices matter.

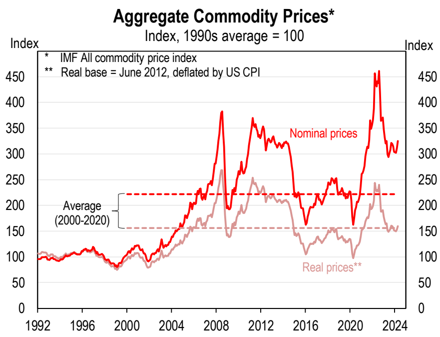
Different drivers mean different implications for growth, inflation and interest rates. As we have noted before, if commodity prices stay high, they are likely to contribute to the 'sticky' inflation challenge.

1. Commodity prices have been in an upswing since mid-February



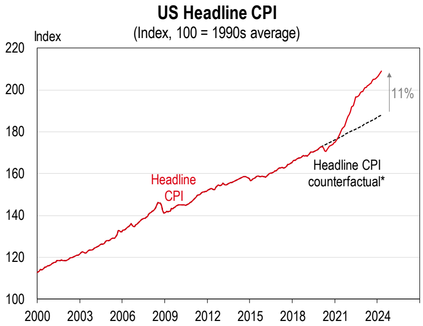
Source: Bloomberg; HSBC

2. Real commodity prices are around their pre-pandemic average



Source: IMF; Bloomberg; HSBC estimates

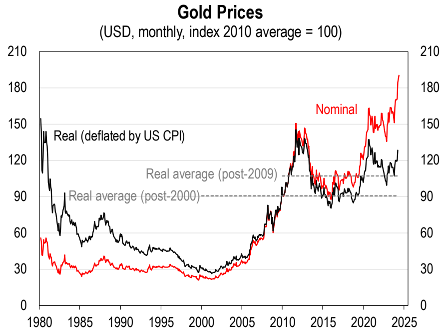
3. Consumer prices have seen a level shift



* Assuming headline CPI averages 2% y-o-y from December 2019 onwards

Source: Refinitiv Datastream; HSBC

4. Gold prices at nominal highs, but around average in real terms



Source: IMF; HSBC estimates

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