WCU: Inflation narrative tripped up as Trump gets Covid

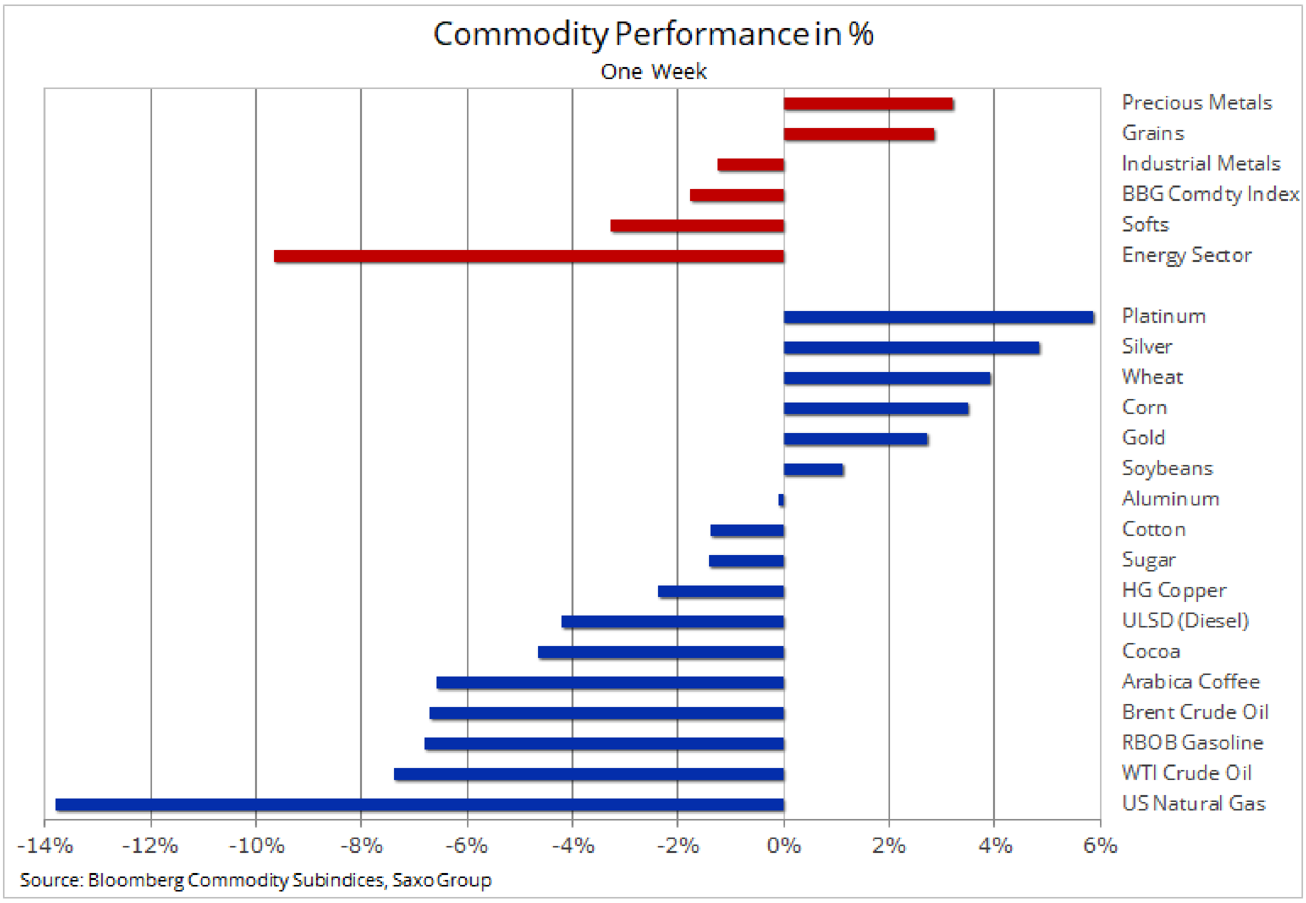
By Ole S. Hansen | October 2, 2020

Link: https://www.home.saxo/content/articles/commodities/commodity-weekly-02102020

Commodities traded lower for a second week as the Covid-19 pandemic continues to cloud the global economic outlook and with that the demand projections for several growth-dependent commodities from crude oil to copper. News on Friday that President Trump and the first lady had both tested positive helped strengthen some of the moves that had already started earlier in the week.

President Trump's positive result initially sent stocks lower while gold and the U.S. dollar rallied. It will likely sharpen already intense attention on the President's handling of the pandemic as he campaigns for re-election against Joe Biden, who leads in national polls. For now, the market has taken the view that the latest development may further weaken Trump's chances of re-election, a development that is being treated as potentially dollar negative, hence the Greenback's limited positive reaction to the news.

Precious metals continued to recover following the latest correction which, given the relative length it travelled to the downside, did not manage to change the continued positive outlook for the sector in the coming months. Silver and platinum, which got slammed hard on the way down, came top as they played catch-up.



The grain sector came second after ending the third quarter up 12.3%, its best in more than five years. The latest pop came after U.S. Department of Agriculture stockpiles data showed corn, soy and wheat inventories all trailing the average estimates from analysts. Heavy buying of soy and corn by China, as it rebuilds its massive hog herd after the African Swine Fewer outbreak, was a major driver. In addition, lower U.S. yield estimates and dry weather in parts of South America could mean that the sector, after years of oversupply, will begin to tighten.

It was a strong quarter for agriculture commodities in general with the sector finishing up close to 12% with gains seen across all three sub sectors of grains, softs and livestock. With the strong finish for the grains sector, there are now expectations that a lower U.S. production due to adverse weather in August and increased worries about a La Niña event will continue to support the sector over the coming months.

With these developments in mind, the inflationary transition from commodities into the wider economy has received some attention in recent weeks. However, if realized it would represent the worst kind of inflation as it will hurt consumers, especially in emerging market economies that can least afford it. However, countering these reflation concerns were developments across growth-dependent commodities such as energy and industrial metals where crude oil and copper traded lower in response to weakening fundamentals.

Crude oil extended its decline due to continued worries about the pace of the recovery in global fuel demand together with increased focus on OPEC and its ability to keep production down. This comes after Libya's oil industry, all but shut down since January because of civil war, began to recover, potentially leading to rapid output growth over the coming months.

The demand side, meanwhile, remains troubled by the continued rise in Covid-19 cases leading to renewed lockdowns. With the timing of a widely available vaccine still uncertain, the captains of the three biggest independent oil trading houses don't see a meaningful recovery in global oil demand for at least another 18 months.

Having found resistance at $42.60/b, Brent crude turned lower and broke below recently established support to touch the lowest level since June. The market will now be focusing on the June 12 low at $37/b as the next key level of support. Given the potential for a continued slowdown in U.S. oil production and the risk of additional action from the OPEC+ group, we struggle to see oil run into another April-styled collapse. What is abundantly clear, however, is that the recovery will not occur until the pandemic is either brought under control or a vaccine is made widely available.

Source: Saxo Group

Gold returned to relative safety above $1900/oz following the recent correction which, from a technical perspective, was a relatively weak one within the established uptrend. Investors using exchange-traded funds backed by bullion have stayed very resilient since gold peaked back in August. Despite having seen a top to bottom correction of 226 dollars, total holdings did not suffer any setbacks. The current 110.9 million ounces in total holdings are just a whisker below the recent record.

We maintain a positive outlook for gold and while we may not see any significant near-term developments in real yields and inflation, the uncertainty ahead of the November U.S. presidential election should be enough to dissuade anyone from taking profit before our expectations for a weaker dollar and lower real yields eventually may take prices higher into 2021.

Source: Saxo Group

Copper which in recent weeks we had warned looked increasingly at risk of a correction dropped the most since March. This was in response to easing fundamentals as seen through the recent spike in stocks at LME monitored warehouses and a brewing slowdown in China as credit begins to tighten, Adding to this, the recent dollar strength and an elevated speculative long held by funds, the price had increasingly been left exposed to a pull back after recording six straight months of gains.

From a technical perspective, HG Copper has already reached its first target at \$2.84/lb with the next key level being the August low at \$2.7850/lb.

Source: Saxo Group

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