“Commodity prices will continue to escalate”

- Günther Rehme

In continuation of our Friday's topic on commodity markets, Dukascopy has interviewed another expert in the financial markets field, Günther Rehme, Assistant Professor of Economics at Technical University Darmstadt, Germany. During the talk the Porfessor has provided the forecasts for the commodity markets and recommendations for the investors.

Günther Rehme

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Professor, what are the factors driving the current commodity markets and how are they different from 2008?

My view is that in 2008 the Lehman brothers played a big role in the collapse of all the markets. The drivers that led to the upswing back then are now basically the same being pushed mostly by emerging economies, especially China, as well as mounting demand for commodities as China requires a lot of raw materials to sustain its production capacities.

What is your forecast for the commodity prices in the coming year?

The commodity prices are falling a bit at the moment, but on the whole we see them rising. If you ask me about the forecast, I would follow the IMF that conducted a research in late September 2011.

So if we look at some broad aggregates, like the metal price indices, IMF predicts that the level will be slightly lower in the next two quarters of 2012 and the next year will be approximately at the level of the Q3 in 2011. The fuel price index may stay on the same level in the Q3 of 2011, slightly lower, but the price decreases in these broad categories will not continue according to IMF. The food price index roughly will be at the level of Q1 in 2011 and agricultural raw materials may decline to the level of 2010 of Q3. These are the IMF predictions. I would like to follow them.

But then, given the current situation in Europe, the prices also depend on global demand conditions and given the uncertainty in Europe, of course, it depends on the big players in the West as well. If the demand in the US and Europe slackens, consequently, the prices may continue to drop. It hinges on whether we will see a recession in Europe in the foreseeable future as the growth prospects are not very high in Europe.

The European Union is certainly one of the largest demanders, the largest economic block in the world. So if demand slackens there, it will be reflected in the prices, but on the whole, if there is going to be a very mild recession or just a growth slowdown, I would say that the commodity prices will continue to escalate, especially if you look at them in the medium-term or in the long-term run.

I personally consider that the markets do not expect that Europe collapses or jumps into a harsh recession, otherwise it would have been anticipated in the prices already and I do not see it. We do not know what happens in Europe and also the US situation is unstable, but on the whole I do not see a very big recession at the moment.

If we take China, it has been a big player in the commodity markets for quite some time and there is a visible upward movement in the commodity prices since 2004, so the medium and long-run see upward movement in all price indices, which, I believe, will continue.

What would you recommend for the investors in terms of analysis of commodity markets?

As an investor, if you invest in metal or fuel funds, there might be a broad picture in the medium to long-term perspective I think the prices will be increasing which can only be stopped in case of the crisis.

In addition, I would look at the submarkets and would closely follow what is going on there because not everything that we see in the indices of such important commodities as gold, Brent oil, etc. reflects the real situation. It is crucial to look at each commodity separately. The thing is that not all deals are transacted on the market like a merchant products change or so. A new feature on the market is that, for instance, China enters bilateral trade agreements which do not happen over exchange places like Chicago, New York or London. That has an impact on the prices you see in the commodity indices. China enacts contracts with Argentina on corn; it goes for precious metals and sets up its own contracts for various countries so that the exchange places are not used. This new feature raises prices as once the deal is signed it makes the commodities scarcer which, in return, drives the prices up.

If you read German media today, special agencies have been set up to advise firms to actually seek the precious metals for industrial input as there seems to be a hunt for metals, agricultural products and alike, however, the problem of bilateral trade agreements is still what is needed to take into consideration.