Trampled under Thucydides

Global economic outlook in the shadow of US-China struggles

BCA

2024

GLOBAL MACRO PANORAMA – PART 1: COMMODITIES

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Executive Summary

- The year 2023 saw normalization from the supply and liquidity shocks in 2022. The path to normalcy was smoothed by three critical elements: commodities (especially energy), China's recovery, and US fiscal policy. Each of these, however, carry the seed of potential instability that may throw the global economy off-kilter in 2024 and beyond.
- Falling oil prices, in part due to issuance from the US SPR, enabled the US (and other countries) to defy the Phillips curve tradeoff by having a decline in inflation without a rise in unemployment. However, global oil consumption growth is now starting to overtake production, partly due to continued output cut by OPEC+.
- Two factors serve as buffers against a potential spike in global energy prices—high worldwide inventory levels and increased US shale oil output. The latter, however, bears the hallmark of a consolidating industry rather than an expanding one, implying possible return of price pressures in the longer-run.
- Global food inflation has eased due to lower fertilizer prices and El Niño weather phenomenon. However, the latter mostly helps temperate crops, while the prices of tropical produce have remained elevated.
- China's supply-side stimulus may not be a major boost for commodity prices, given large excess inventories that have been built up particularly for coal and nickel. Closing this supply overhang requires both a reduction in output and an increase in demand for fixed-asset investment, which appears to be help in the case of copper.
- Ongoing supply chain disruptions due to Houthi attacks in the Red Sea may not boost commodity prices as some might expect, if it leads to a delay in the highly-anticipated Fed pivot. Without "cooperation" from the Fed's loose policy, commodities may not undergo a sustained multi-year boom à la the 1930s, 1970s, or 2000s despite the backdrop of geopolitical turmoil.
- The outlook for industrial metals is tied to the complex dynamics within China's manufacturing industries. Certain metals like copper seems to show signs of an incipient recovery, but others like nickel remains plagued by a large oversupply.

This is part 1 of 4 in our Global Macro Panorama

Part 1 – Commodities

Part 2 – China

Part 3 – US macro policies

Part 4 – Core and periphery

** all data and forecasts are updated at least one week prior to the original publication date, on Feb 2nd 2024*

Introduction

- The global economy enters 2024 with a degree of guarded optimism. Inflation has been tamed without (as of yet) triggering a recession, while ongoing —and even escalating—international conflicts are seemingly relegated to background noise with little impact on the broader market.
- *"Soft landing"* becomes the watchword *du jour*, and quite justifiably. Supply-side pressures, as seen through commodity prices, have greatly eased. The same is true for global liquidity, as measured by the price of the US Dollar which remains the dominant global currency, despite plenty of hue and cry.
- If these were less interesting times, it would be hailed as a return to *"Great Moderation"*. But those halcyon days—pre-GFC, pre-COVID-19, pre-Ukraine —are long gone, and extreme economic swings are no longer seen as rare aberrations.
- But a swing in which direction? Predicting that things would mean-revert following a shock is trivial. Guessing which way a system might tip over after ostensibly regaining balance is entirely more difficult.
- Still, try we must. To that end, we need to look at three pivotal elements: ***commodities***, ***the Chinese economy***, and the ***US fiscal policy***. These three factors played key roles in the apparent soft landing of 2023, but they are also in unusual, potentially unstable situations that could bring about new shocks in 2024 and beyond.

Landing the plane smoothly

After a harrowing ride into the unknown in 2022, both commodities and the US Dollar have returned to relative normalcy

index (100 = last 5Y average)

220
200
180
160
140
120
100
80
60
40

60 70 80 90 100 110 120 130 140

index (100 = last 5Y average)

tight supply, easing liquidity

tight supply, tightening liquidity

supply slack, easing liquidity

supply slack, tightening liquidity

Jun-08
Nov-74
May-22
Oct-21
Sep-22
Dec-23
Dec-87
Feb-85
Mar-20
Jan-16

Notable:

- The Dollar and commodity prices are negatively correlated (-0.41), as expected—easing liquidity boosts demand and cuts supply slack. By that token, the situation in 2022 was highly unusual, with strong commodities *and* USD.
- Extreme shocks in the upper-left quadrant tend to coincide with crises in developed economies (70s stagflation, GFC), while those in the lower-right tend to affect EMs more (80s debt crises, mid-10s commodity/currency crises).

Source: *Bloomberg, BCA Economist*

** each dot represents one month since 1971, i.e. the transition point from Bretton Woods to fiat (euro-)Dollar system*

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Part 1

Commodities

The real inflation reduction act

- Throughout 2023, US inflation declined without a corresponding increase in joblessness, defying the conventional Phillips curve model. Some saw this as evidence that the curve is broken, or even an "undead" relic perpetuated in macro textbooks.
- But we see it differently. The Phillips curve tradeoff remains evident, but it is buffeted by supply-side factors, particularly energy prices. Notably, the US *"Misery Index"* (the sum of inflation and unemployment rates, i.e. the two horns of the Phillips curve dilemma) is clearly correlated with energy costs as a share of GDP.
- This means that the Phillips curve shifts outward with higher energy prices and inward with lower prices. The latter was precisely what we observed between Q4-22 and Q2-23, when oil prices rapidly declined.
- In a way, then, the role of monetary and fiscal policies is mainly to allocate the "misery", rather than alleviating it *per se*. Essentially, policymakers get to decide whether to confine the misery among a minority of job losers, or spread it thinly (and perhaps less perceptibly) via inflation. US policymakers during the 1970s, still in thrall to the New Deal consensus, effectively chose the latter, while the neoliberal order of the 2000s pushed things towards the former.

- Instead of Fed rate hikes, then, the key factor behind the soft landing may actually be the release of oil from the Strategic Petroleum Reserve (SPR) by the Biden administration between Nov-21 and Jun-23. By the latter date, however, the admin had become concerned by the thinning reserves, and shifted towards a refill—albeit one that is taking place very slowly.

A race of endurance

- Seizing this opportunity, OPEC+ announced a series of output cuts early in Q3-23, temporarily driving up oil prices. Luckily for the US, its shale drillers stepped up production, compensating for lost output from OPEC+.
- The outlook for oil supply now hinges on a race of endurance between US shale and OPEC+. The former's surge has the potential to crack the latter's united front, if Saudi Arabia chafes at losing market share without reaping substantial price gains.
- Yet, a repeat of a similar scenario to 2014 or 2020—where the Saudis broke with OPEC+ to increase its own production, causing oil price to crash in the process—appears unlikely for now.
- The output cut has become a valuable bargaining chip to use against the US, particularly amid escalating tensions in the Middle East. The Saudis would probably concede it only if prices fall significantly further, or if the US offers a suitable *quid pro quo* diplomatically.
- What about US shale? It might seem odd that an industry that so recently emphasized capital discipline and aimed for higher margins is now pumping away with abandon despite diminished prices.
- But this shift has to be seen in the light of a recent surge in M&A deals, as oil majors such as Chevron and Exxon are rapidly acquiring the smaller shale drillers. The increased output seems to represent, in part, attempts by these smaller entities to cash out before making their exits.
- It is also remarkable that the oil majors opt for M&A rather than investing in new production, reflecting caution about the industry's long-term outlook. With oil demand entering a potential long-term slowdown due to the rise of EVs and renewables, the industry is beginning to pre-empt the risk of price decline through consolidation.
- This trend towards consolidation—plus the general decline in US shale's per-well output—makes it doubtful if the shale boom could outlast OPEC+ cuts, let alone the geopolitical shakeup that could take years to play out.

The great hoard

- Even with the recent upswing in US shale output, global oil demand growth is starting to outpace supply for the first time since H1-22. Historically, this tends to signal a forthcoming increase in prices, even though the price gains since the start of 2024 has been quite limited.

- However, a substantial portion of this demand surge seems to be driven by inventory buildup rather than genuine consumption. China seems to be the main culprit behind this buildup—after all, there is ample evidence that it has also been stockpiling coal for the past two years.
- This is a result of the Chinese government's emphasis on energy security, which stems not only to geopolitical concerns—even, some might say, a sign that an open conflict may break out soon—but also crucially from its energy crises in 2021-22. At that time, China suffered from rolling blackouts due to coal shortage and a drought-induced drop in its hydroelectric output.
- To prevent a repeat of such crisis, China is making heavy investment in clean and "dirty" energy sources alike. It also ramps up coal imports, in spite of an increase in domestic coal production and a concurrent rapid growth in renewable energy, which eats into coal's share in the energy mix.
- Concerns regarding energy security are not limited to China alone, and this is par for the course given the geopolitical backdrop. European gas storage, for instance, has been filled to capacity before winter, even as demand has been plummeting amid an overall decline in the continent's manufacturing industries.
- This growing fuel stockpile may have the effect of mitigating the volatility in energy prices. The relatively muted price response to the ongoing Middle Eastern conflict does seem to bear out this hypothesis, and it might take a bigger conflagration to drive up prices to a similar extent as in 2021-22.

Feast and famine

- As with energy, the outlook for other commodities does not paint a straight-forward picture. A prime example here is foodstuffs, where the high global temperatures exacerbated by El Niño has led to diverging trends between two groups of crops.
- On one hand, temperate-climate staples such as wheat, corn, and soy have witnessed price declines in recent months. These crops seem to enjoy a big stroke of luck, as they benefit from El Niño and decreasing fertilizer prices—the latter being the corollary of easing energy prices.
- On the other hand, the prices of tropical crops like rice, coffee, and cocoa are still elevated. Altogether, then, we see an easing of food inflation in the northern hemisphere, but a far trickier situation in the Global South—and we cannot help but think that this could be a preview of things to come as the earth's atmosphere continues heating up.

Not as rosy as it seems

- The outlook for industrial metals are similarly mixed. Some commodities like nickel continues to be plagued by oversupply, as China's steel industry—having vanquished its competitors abroad—itself suffers from overcapacity amid anemic demand for domestic construction.

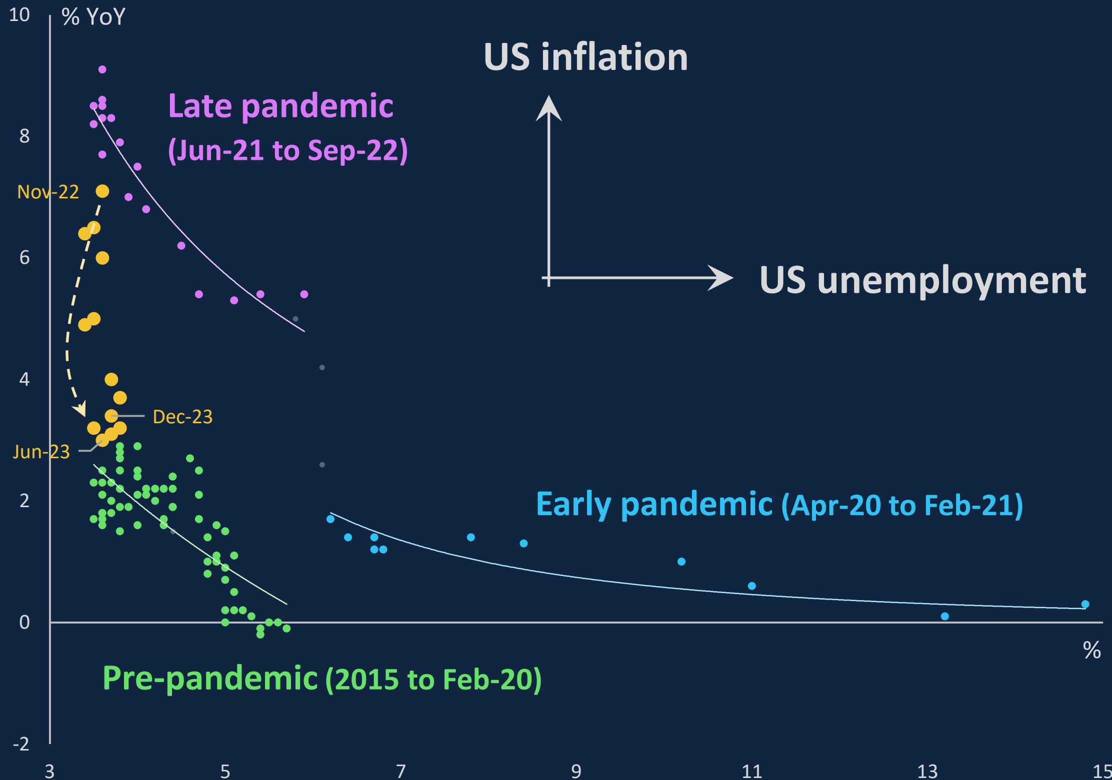
- Meanwhile, a few other commodities like copper have better price support as their previous supply overhang diminishes. This, however, is not entirely down to stronger demand, but is also helped to an extent by lower output—which is not unlike the situation for nickel.
- Given China's outsized demand for these metals, its supply-focused stimulus should be greatly beneficial, at least in theory. The actual situation on the ground, however, does not really support this presupposition. Even in areas where China's industries are booming, most notably in EVs, the supply glut is such that the price of lithium has actually fallen in recent months, and the stimulus-fueled demand may not provide as big of a boost as expected.

Red (Sea) alert?

- Finally, there is the X-factor of supply chain dislocations. The twin ongoing issues of Houthi attacks in the Bab el-Mandeb Strait and low water levels in the Panama Canal are forcing ships to adopt more circuitous routes.
- Although the impact on shipping costs has not—thus far—been as large as the COVID-driven disruptions in 2021-22, it is likely that we have not seen the worst of the situation, given that the Middle Eastern conflict shows little signs of simmering down. Add in higher costs from the extended lag times and the extra demand for bunker fuels, and we get ourselves a substantial spoiler to the global disinflation process.
- The fact that this situation happens so early in the year, however, may give the Fed a pause in its plans to start easing policy. This potentially dampens the main tailwind for commodities that the market seems to recognize at this point—lower rates and weaker USD. Even those with more favorable fundamentals like oil or copper may struggle to get traction if the Fed keeps a tight policy stance.
- For as much as we argue about the limited role of monetary policy in curing supply-driven inflation, we do think that monetary expansion is a necessary precondition for a sustained, multi-year commodity rally—of the kind that many see as inevitable given the geopolitical turmoil.
- Indeed, we can frame such events like the Nixon shock of 1971 as massive expansions in global claims, which fuel either conflict between consumers and producers of resources (the West vs. OPEC/Russia) or a competition for resources among multiple consumers (the West vs. China in the 2000s). In the absence of such expansions, the potential for such distributional conflict is dampened, even though it can lead to a different set of problems instead —debt deflation and anemic growth, among others.
- As such, Fed policy (which we will discuss in ***Part 3***) remains crucial for the commodity price outlook, as much as the outlook of the Chinese economy (***Part 2***). Our mixed projections reflect the delicate balance between these drivers, with higher expected oil price vis-à-vis other commodities (ex-gold) being a corollary of slowing growth amid an outward shift in the "global Phillips curve".

All gain, no pain

Between Q4-22 and Q2-23, inflation in the US declined without an accompanying increase in unemployment



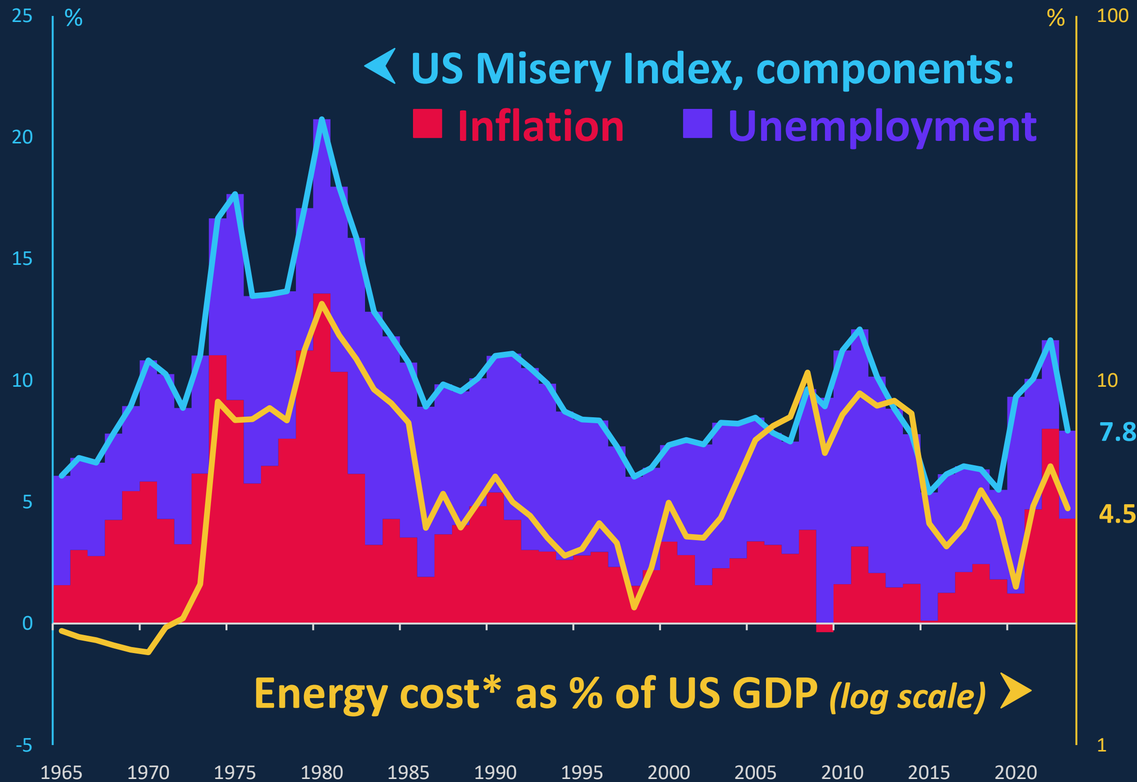
Note:

- The Phillips curve (the tradeoff between unemployment and inflation) can remain stable for a long time, for example during the pre-pandemic shale boom.
- Since 2020, however, the Phillips curve shifted multiple times—firstly due to supply-chain and logistical disruptions from COVID-19 lockdowns, then due to energy crises starting in mid-2021.
- The recent shift inward, occurring between Oct-22 and Jun-23, coincided with a sharp fall in oil prices, from USD 87/bbl to USD 70/bbl (WTI).

Source: *Bloomberg, BCA Economist*

No poverty like energy poverty

The Phillips curve's apparent inward shift in 2023 was ultimately down to lower energy prices



Note:

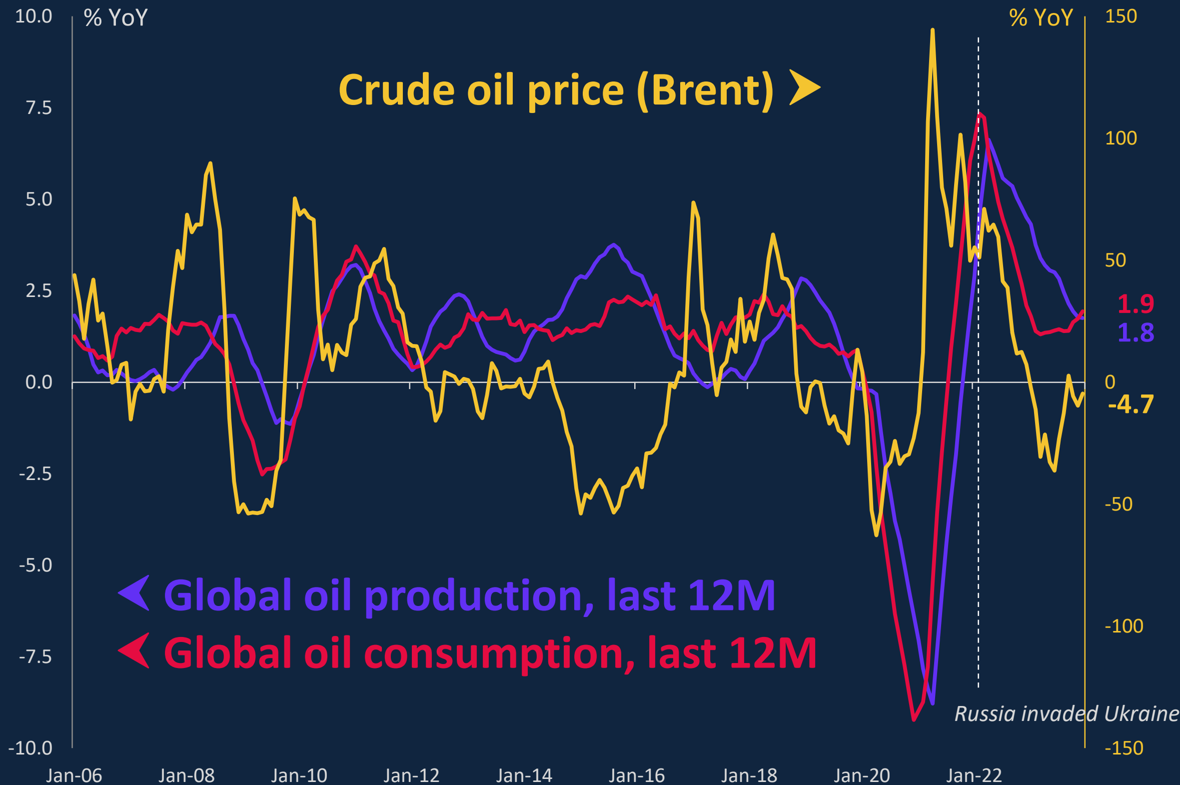
- The *Misery Index* follows energy costs, although the underlying distribution between inflation and unemployment is still a function of policies and politics:
  - In the 1970's, the "misery" largely took the form of inflation, due to the power of labor unions, lingering influence of the New Deal consensus, and a reluctance (pre-Volcker) to impose monetary discipline.
  - In contrast, between 2003-13, the "misery" was mostly reflected in unemployment, as US labor lost bargaining power (due in part to outsourcing), policymakers adopted neo-liberal thinking, and the Fed shifted towards inflation-targeting framework.

Source: *BP Statistical Review of World Energy, Bloomberg, BCA Economist*

** based on primary energy consumption; per-kJ prices are calculated using oil (WTI) price*

An inflection point?

After almost two years, oil consumption growth are starting to overtake production again



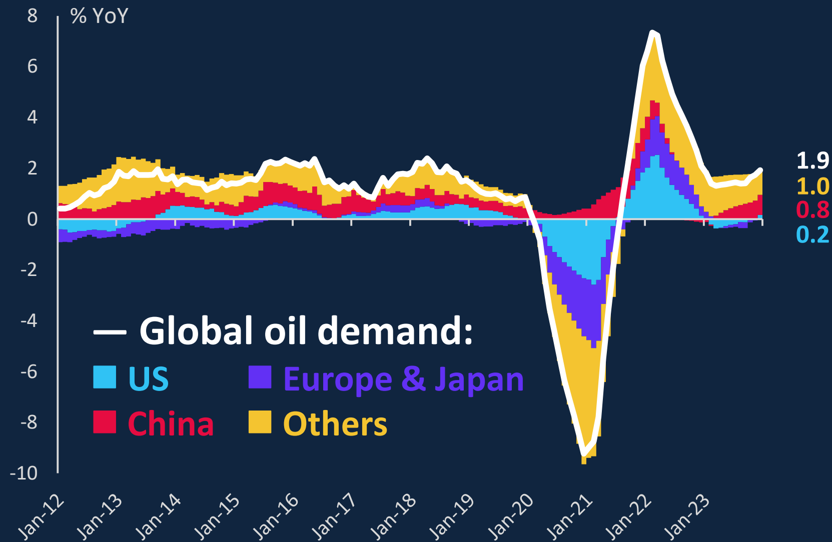
Source: *EIA, BCA Economist*

Note:

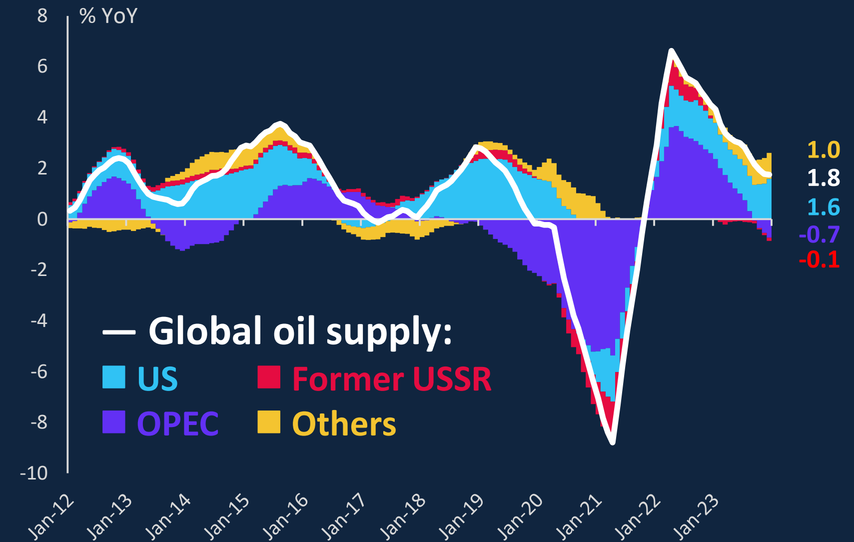
- Intersection of the blue line (global production growth) and the red line (global consumption growth) had tended to signal a change in the trajectory of oil price in the past.
- Between Apr-22 and Oct-23, oil output growth exceeded demand growth, which—in addition to US SPR release—explained the declining oil prices. The two lines have recently intersected again, with consumption on an upward trend.

"Chimerica" preserved in oil

China's recovering oil demand is being matched not by its friends in OPEC+, but by its main geopolitical foes in America



Source: *EIA, BCA Economist*



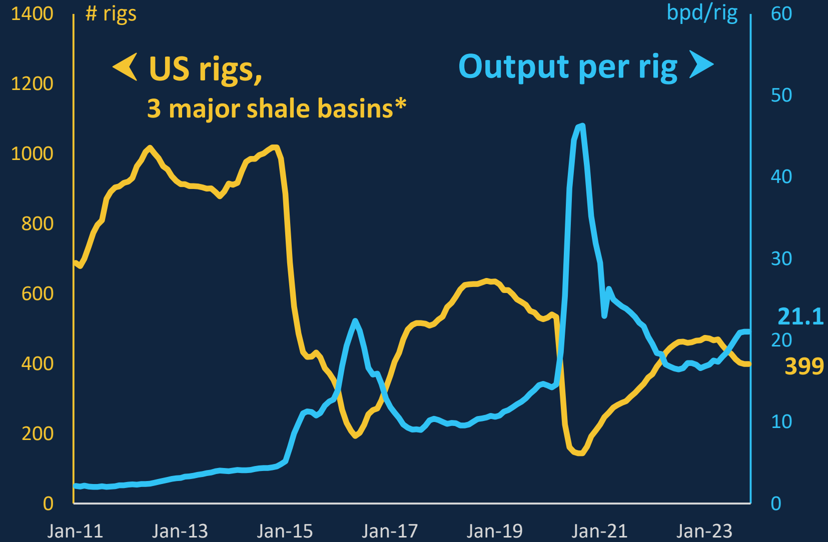
Source: *EIA, BCA Economist*

Note:

- Oil production by OPEC and the former USSR (predominantly Russia) has declined by 1.7 Mbpd between Dec-22 and Dec-23. This, however, is far smaller than the output cut that had previously been pledged by OPEC+, at around 4 Mbpd—plus the 2.2 Mbpd in voluntary cuts announced on November 30th.

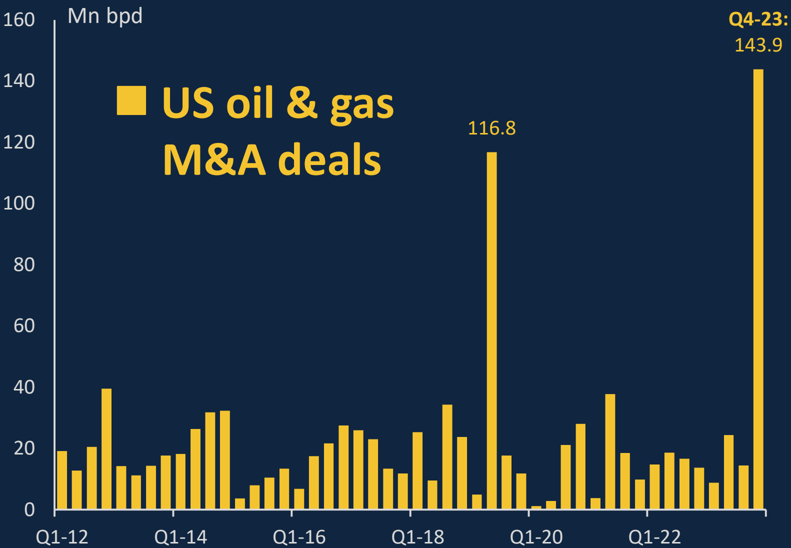
Throwing an exit party

The latest US shale boom does not seem to be a sign of an expanding industry, but rather a consolidating one



Source: *Bloomberg, BCA Economist*

** Permian, Bakken, Eagle Ford*



Source: *Bloomberg, BCA Economist*

Note:

- The US shale industry saw two prior crashes in 2015 and 2020, both times driven by falling oil prices. In both cases, the industry emerged from the crash more consolidated. The present situation, with a modest decline in active rigs but a sharp increase in M&A, seems to represent a new, more controlled and gradual round of consolidation.

The shine's off the black gold?

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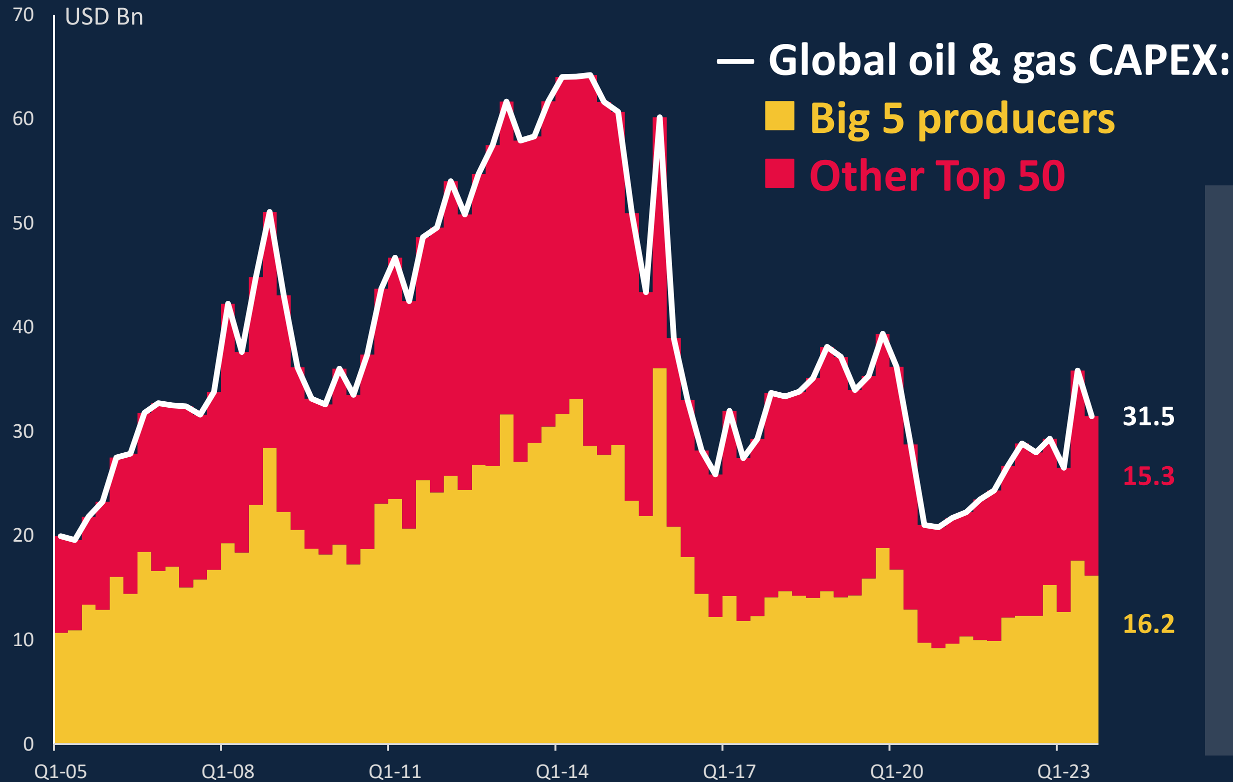
Despite a sharp price increase in 2021-22, the accompanying oil & gas CAPEX had been a pale shadow of past investment booms



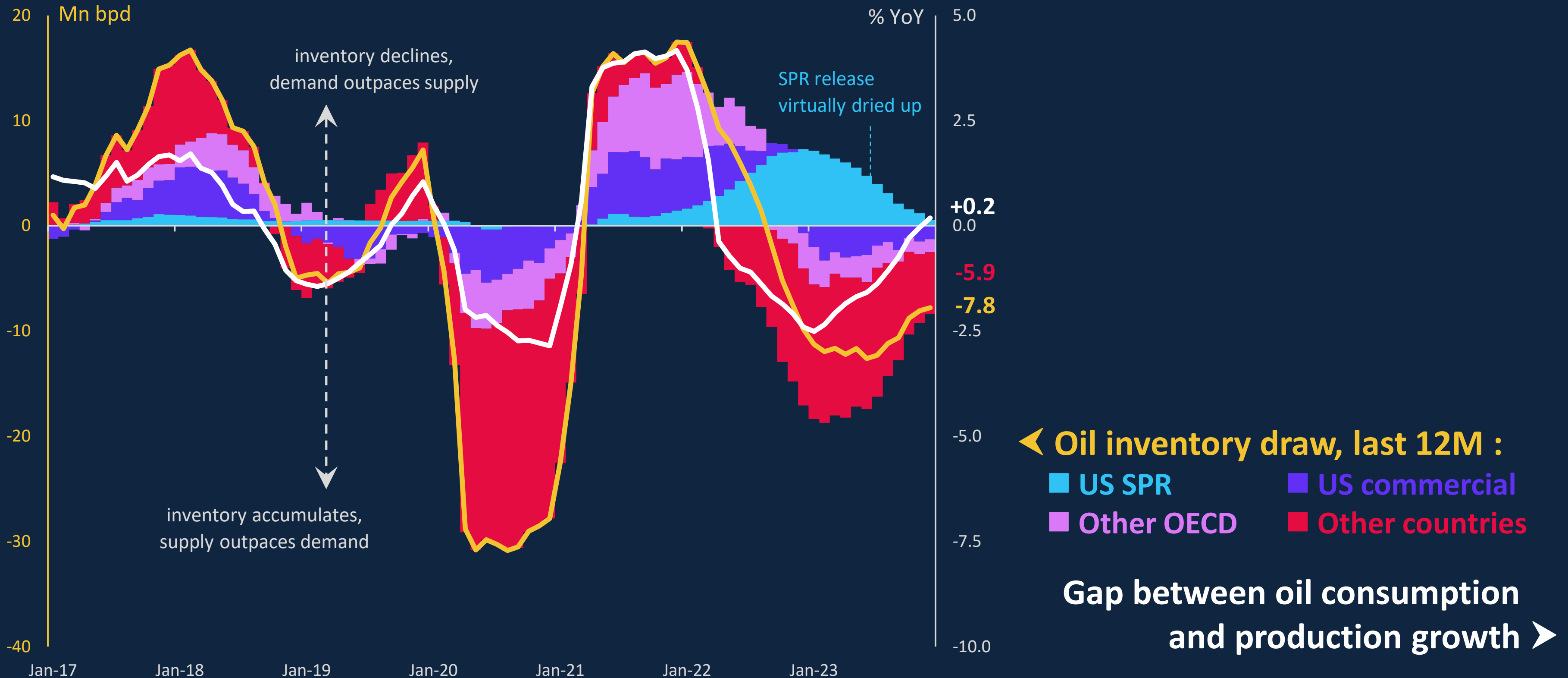
Note:

- The investment boom between 2005 and 2014 was the result of robust incentives (high prices) and an emergent technology (fracking), but also the growing expenses of oil exploration.
- The lower CAPEX since has been the product of lower (and more volatile) prices, as well as negative sentiment towards the oil & gas industry and its future demand outlook.
- Still, the decrease in nominal CAPEX has been somewhat offset by higher efficiency and lower unit prices, and this greater "bang for the buck" may reduce the risk of an acute energy shock in the medium-term.

Source: *Bloomberg, BCA Economist*

Not for burning, just for hoarding

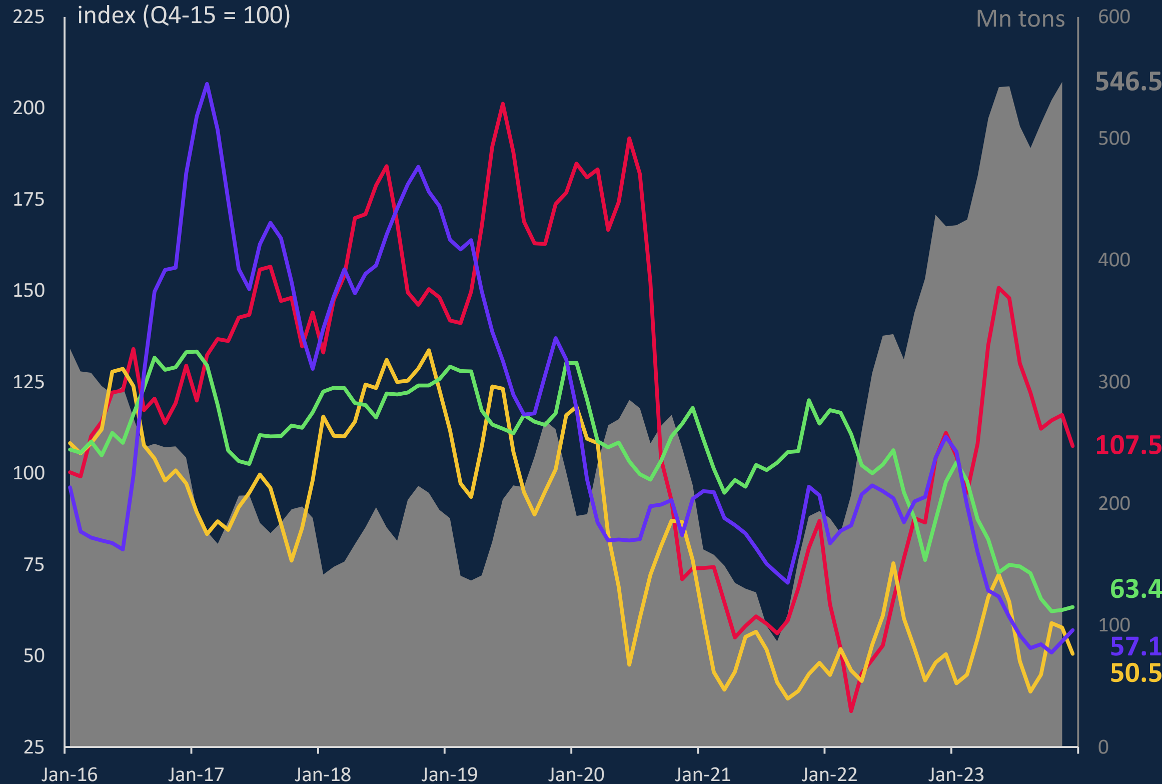
The apparent recovery in oil consumption may instead reflect accumulation of inventories in certain non-OECD countries, most probably China



Source: *EIA, BCA Economist*

Lumps of coal in stock(ing)

China has been the only major coal importer to ramp up their purchase recently—but only to end up as inventories



Note:

- Indian coal imports have remained flat despite its robust economic growth, largely because it has concurrently boosted domestic production.
- Unlike China, however, the growth of the Indian coal inventories have been much more modest: 18% YoY per Oct-23, versus China's 70% (CAGR) in the past two years.

Coal imports:

— China — Japan & S. Korea

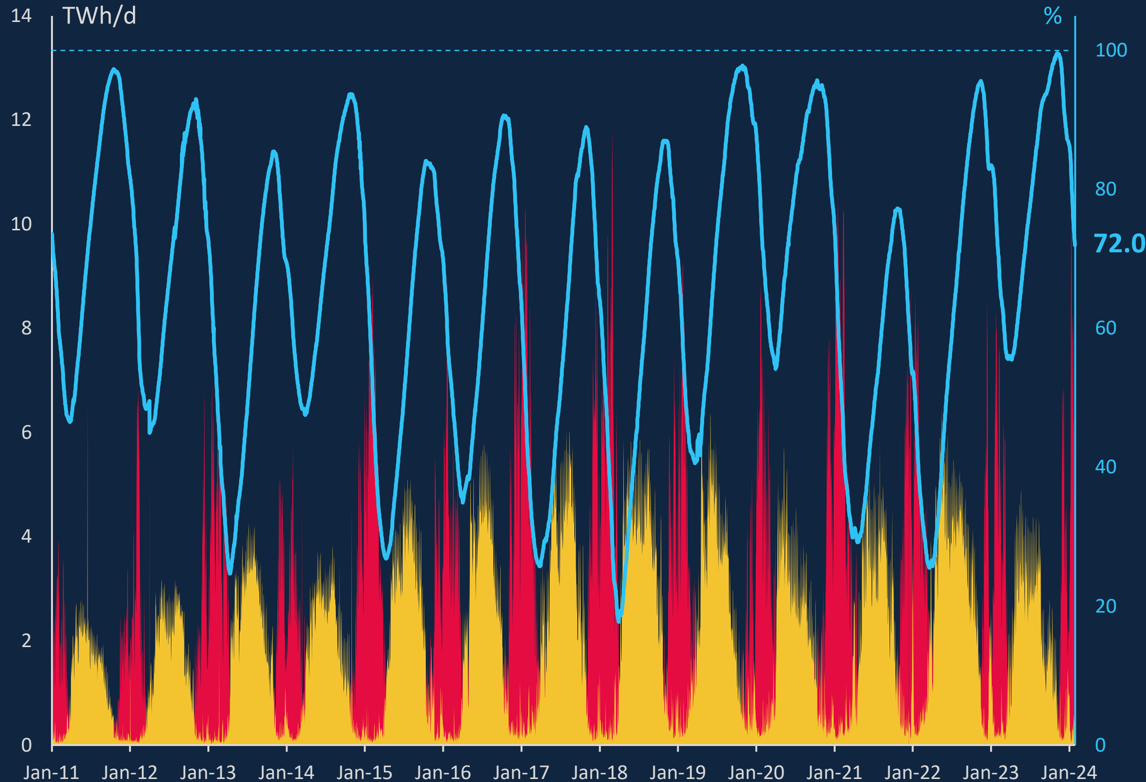
— India — US & Europe

China coal inventory

Source: *Bloomberg, BCA Economist*

Plenty in the tank

Amid slowing withdrawal due to manufacturing contraction, the European gas storage almost reached full capacity prior to the 2023-24 winter



European gas storage:

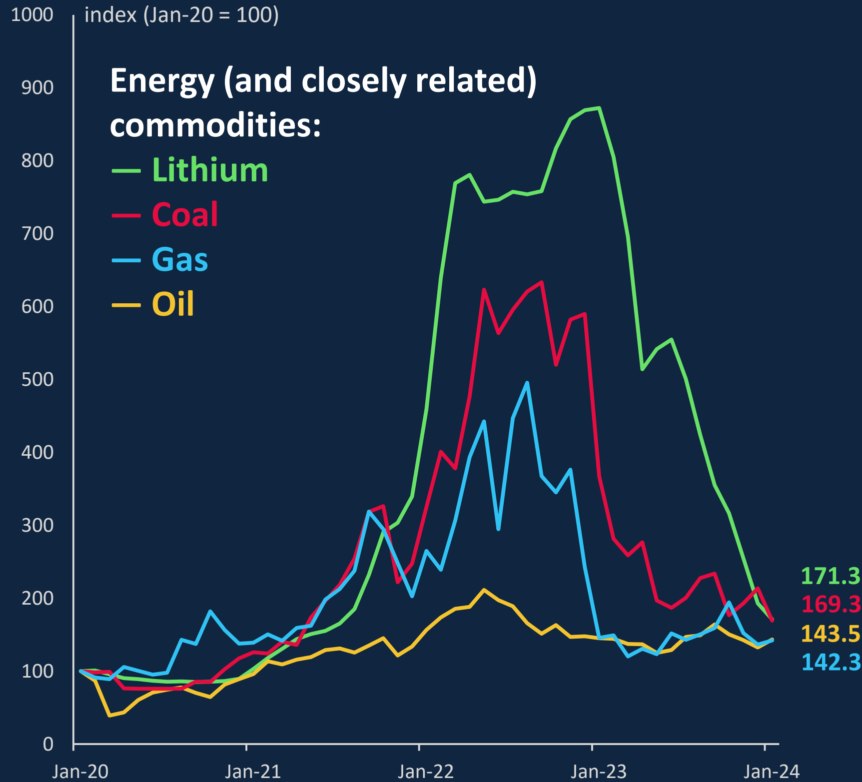
Injection Withdrawal

Storage level (% of full)

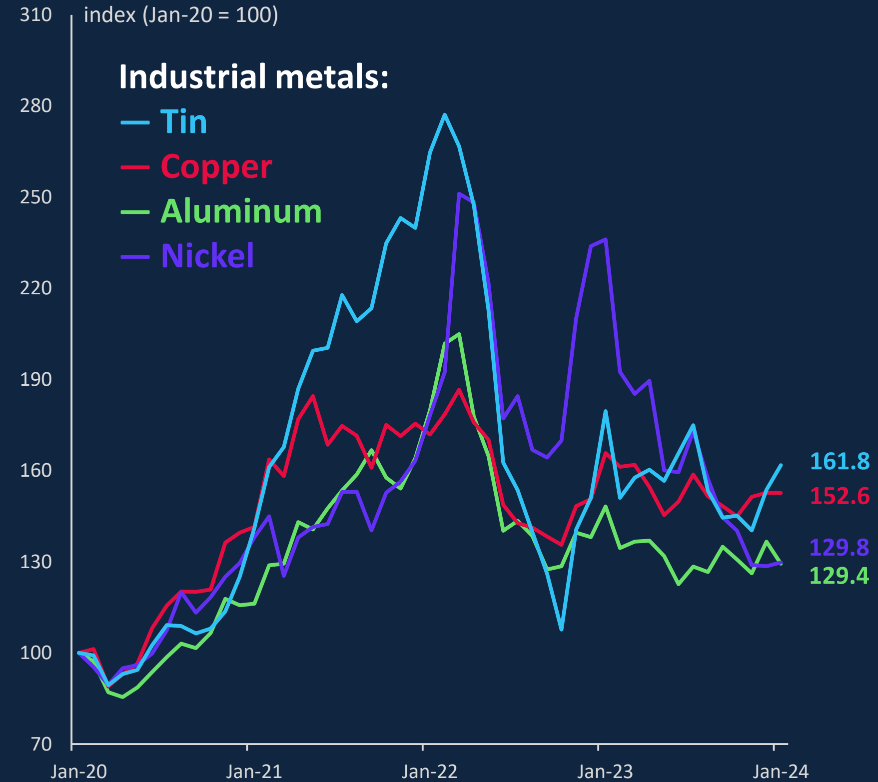
Source: *Bloomberg, BCA Economist*

To the moon and back

The price of hard commodities—including industrial metals but especially energy-related commodities—have fallen after two boom years



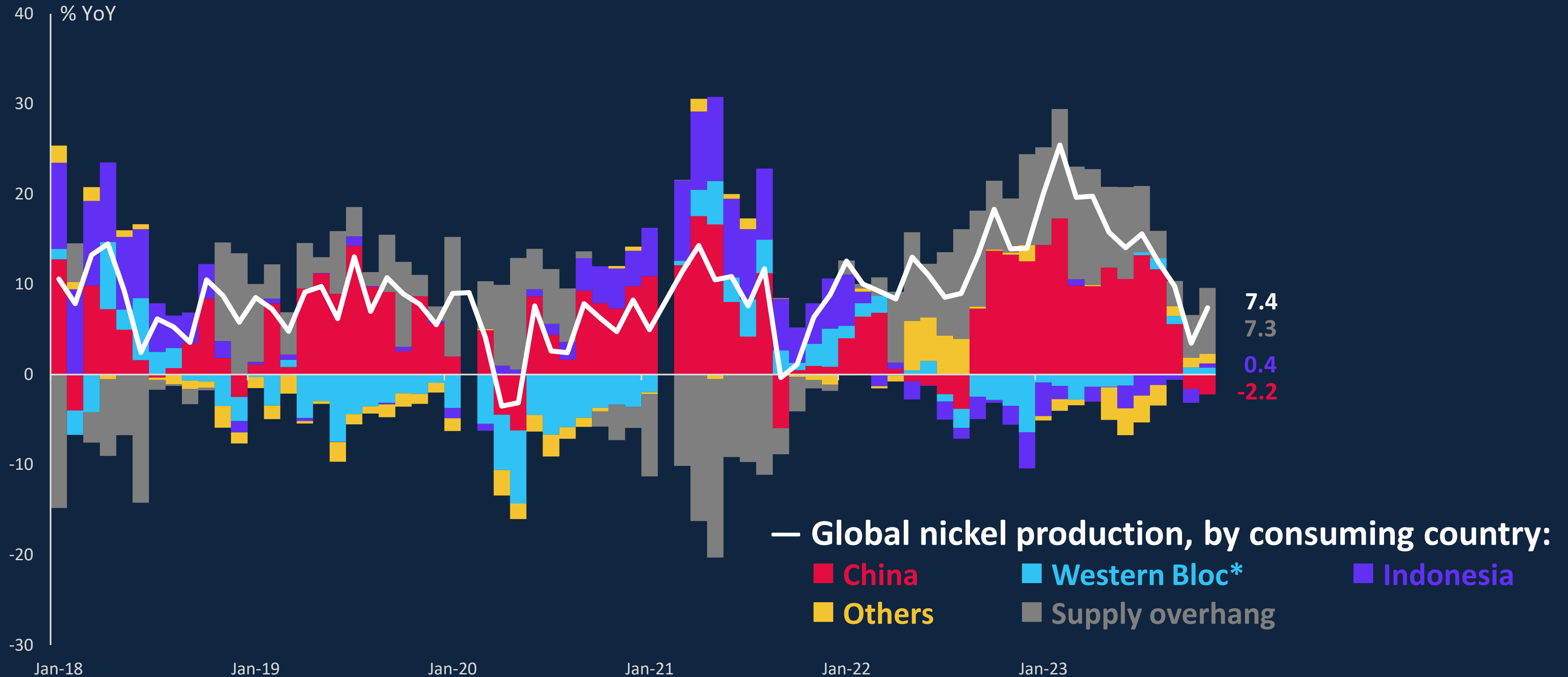
Source: *Bloomberg, BCA Economist*



Source: *Bloomberg, BCA Economist*

The only game in town

China's preponderance in the global steel industry has weakened other countries' industry—which does nothing to clear excess nickel supply

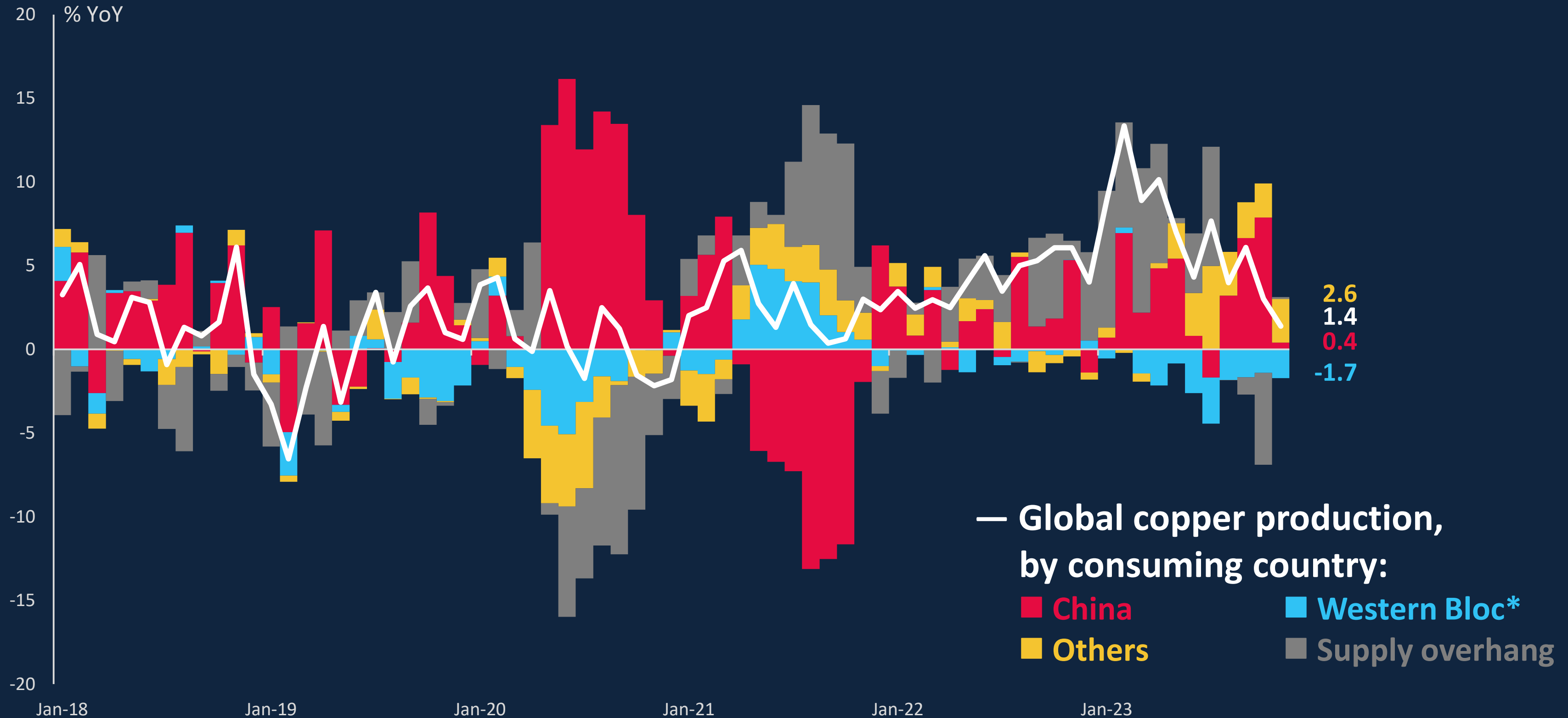


Source: *Bloomberg, BCA Economist*

** US, Canada, Europe ex-Russia, East Asian allies of the US (Japan, South Korea, Taiwan)*

Back from the dead

Copper's supply overhang is clearing up thanks to recovering demand from China and other Asian countries

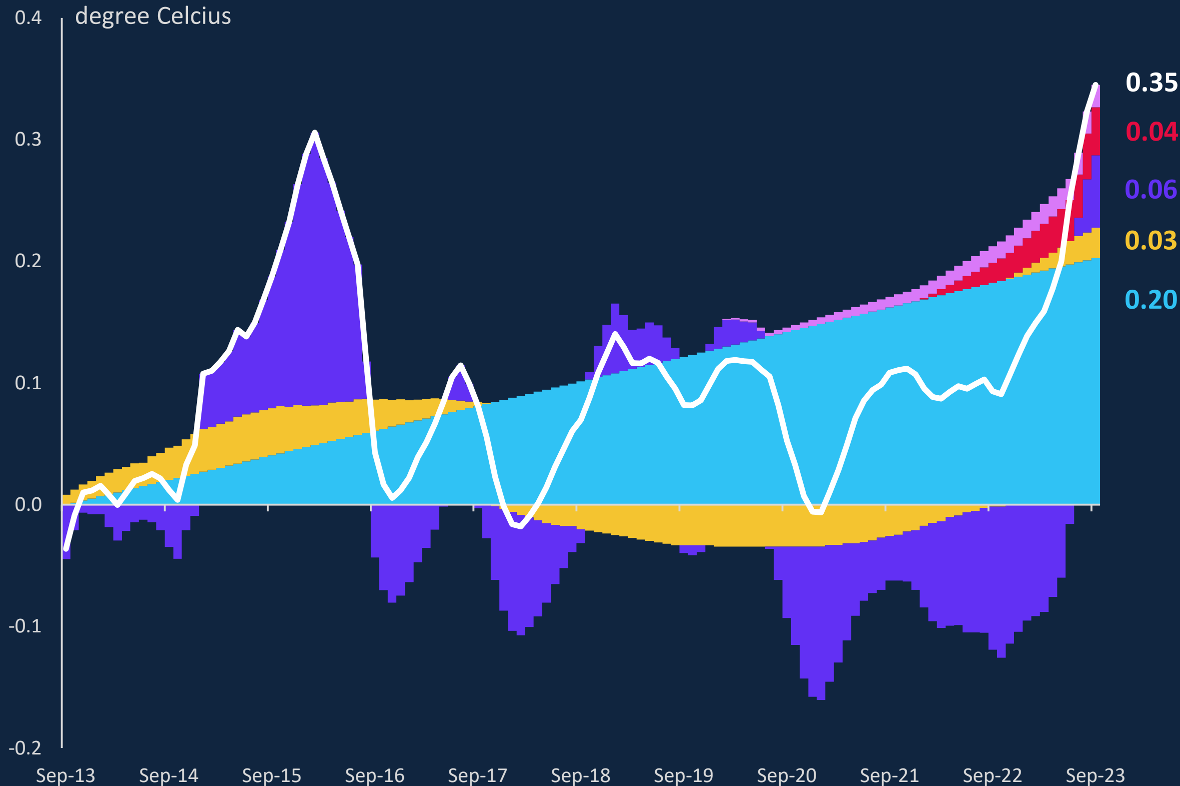


Source: *Bloomberg, BCA Economist*

** US, Canada, Europe ex-Russia, East Asian allies of the US (Japan, South Korea, Taiwan)*

A veritable hothouse

Global temperatures have broken record highs recently due to a confluence of global warming trend, climatic cycles, and other factors



Note:

- The eruption of the underwater Hunga Tonga volcano in 2021-22 released large quantities of water vapor, which temporarily traps heat.
- New shipping regulation in 2020 requiring the use of low-sulfur bunker fuel has reduced the amount of released aerosols that could reflect solar radiation in the atmosphere.

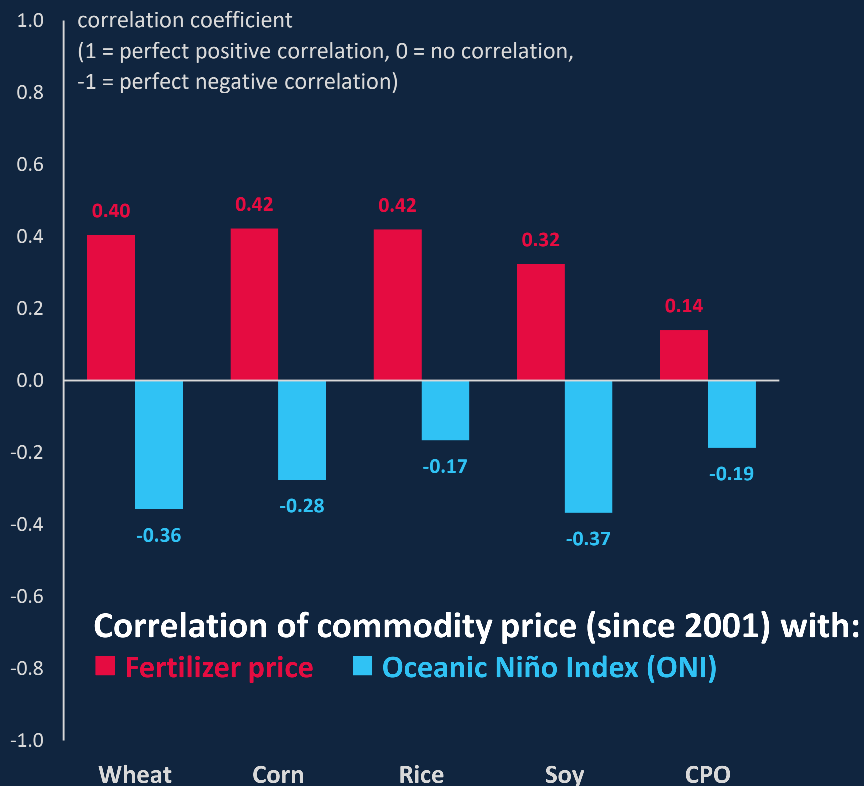
— Global temperature change, last 10 years, by estimated source:

- Manmade emissions
- Solar cycle
- El Niño/La Niña cycle
- Volcanic activity
- Reduced marine fuel pollution

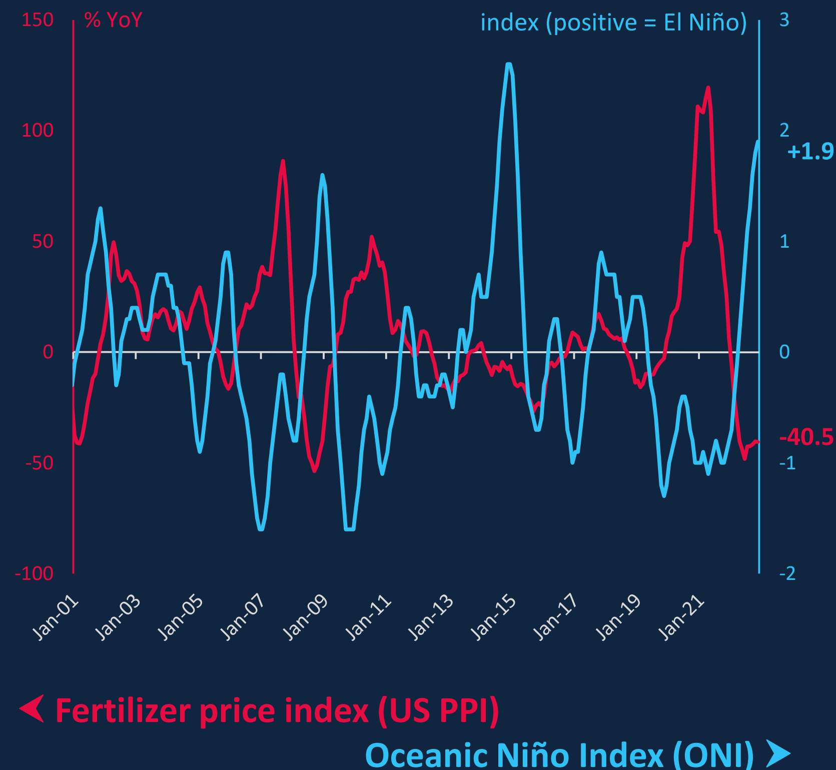
Source: *Berkeley Earth, BCA Economist*

Terribly lucky

El Niño and lower fertilizer prices are lowering the prices of several key agricultural commodities



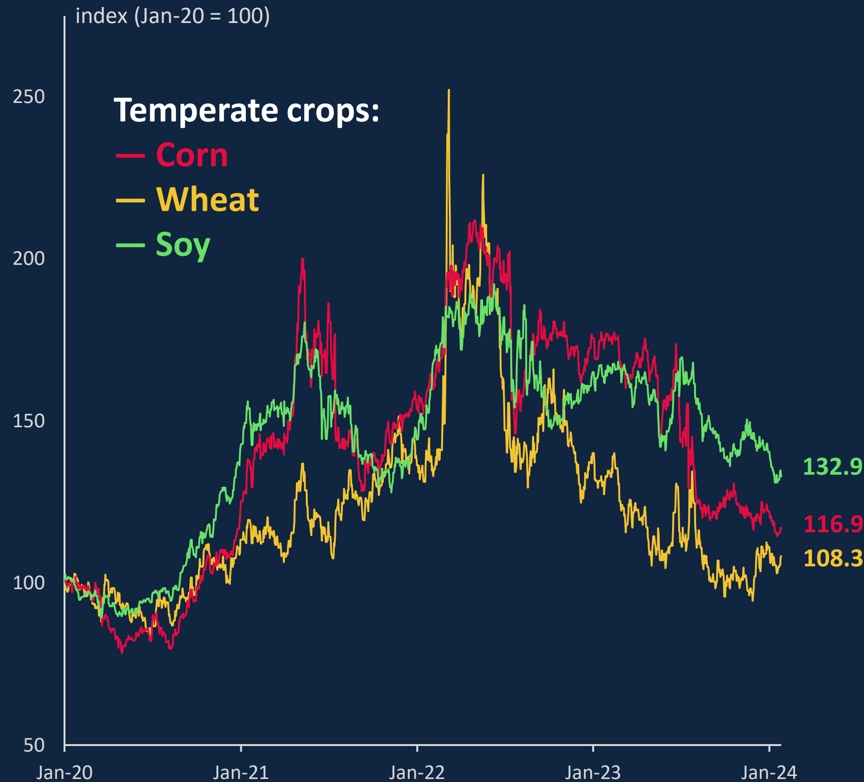
Source: *Bloomberg, NOAA, BCA Economist*



Source: *Bloomberg, NOAA, BCA Economist*

Feast in the north, famine in the (Global) South

The decline in agricultural prices seems to affect mostly temperate-zone crops, while those of tropical crops largely remain elevated



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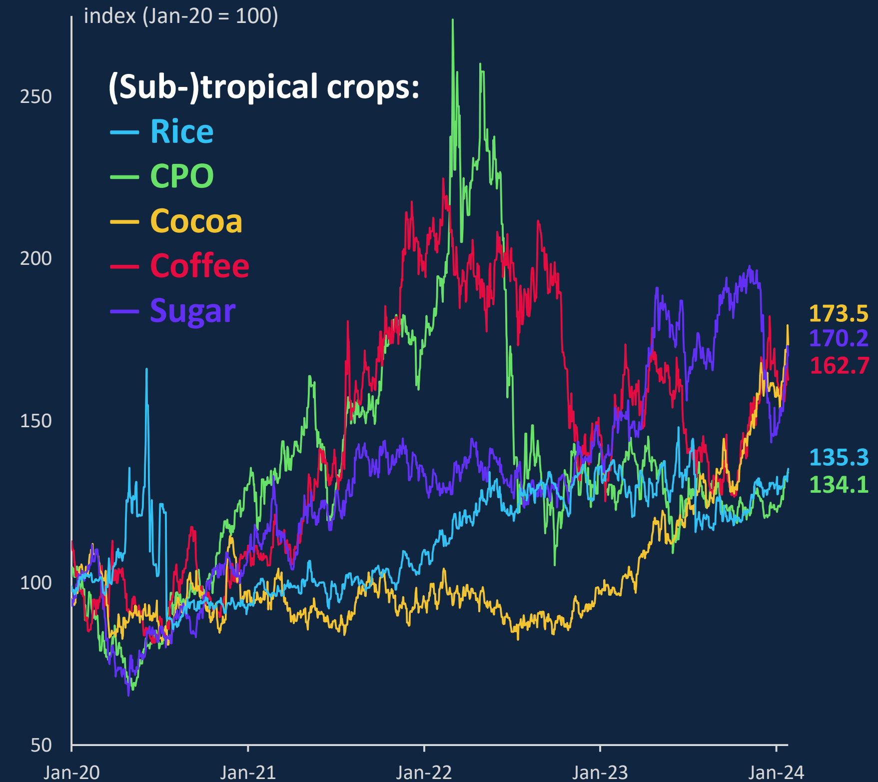
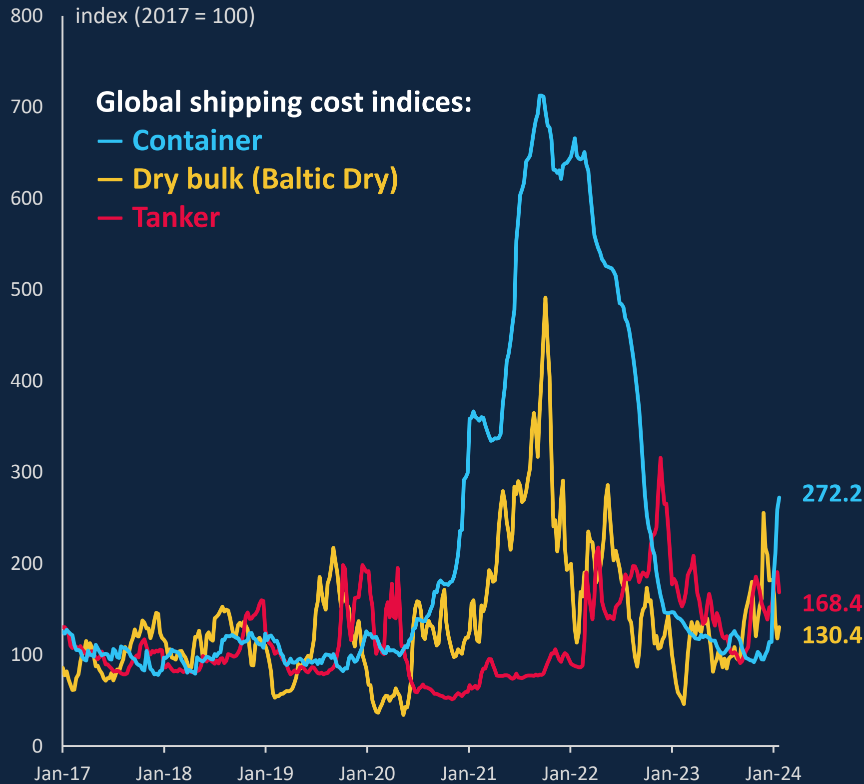


Source: *Bloomberg, BCA Economist*

Not fully priced-in

The impact of Houthi attacks in the Red Sea is only starting to be felt, especially on container routes to Europe



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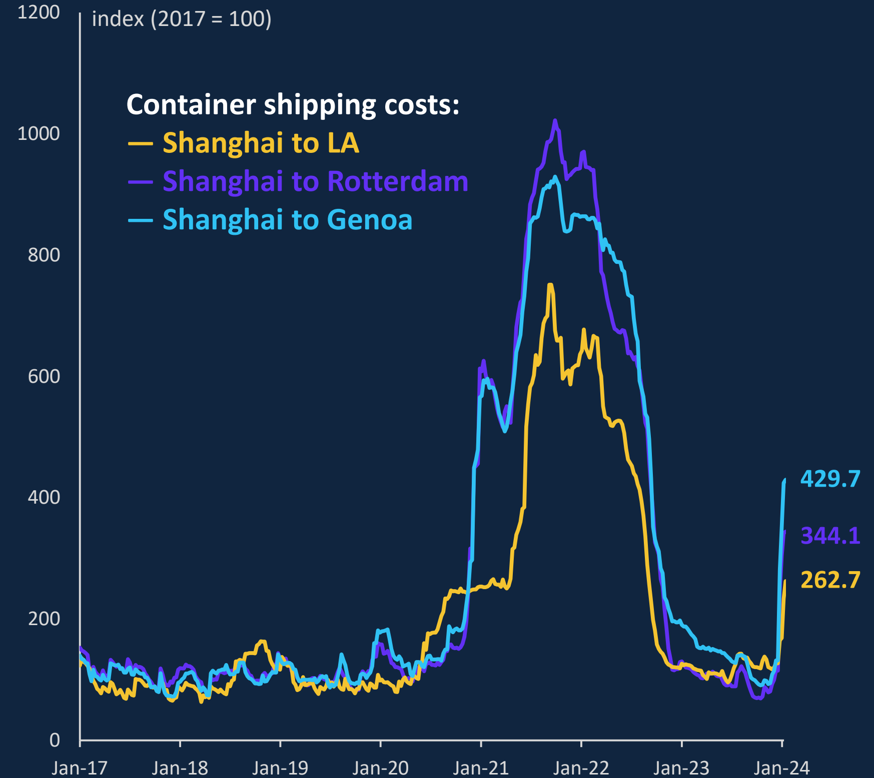
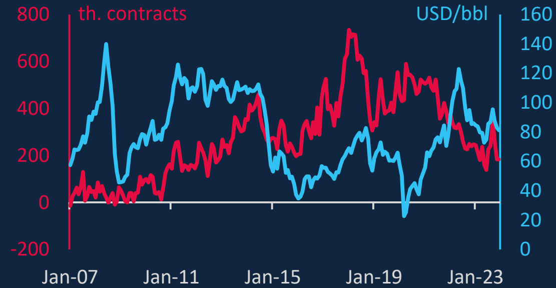


Source: *Bloomberg, BCA Economist*

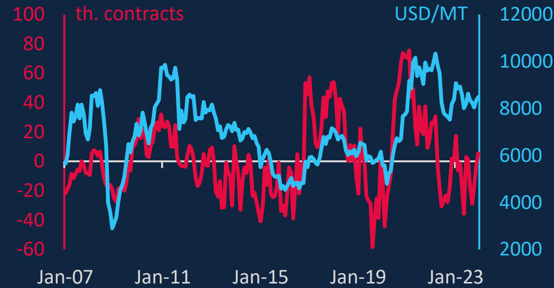
More of the same

The market seems to expect that the soft landing trend—softer commodities, weaker Dollar—would extend into 2024

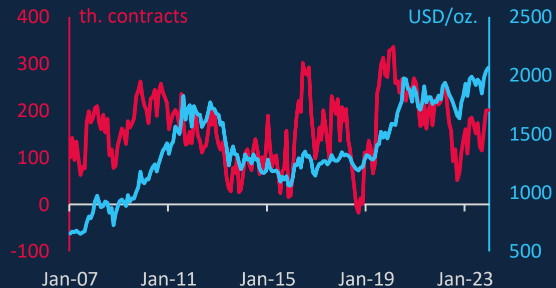
Oil



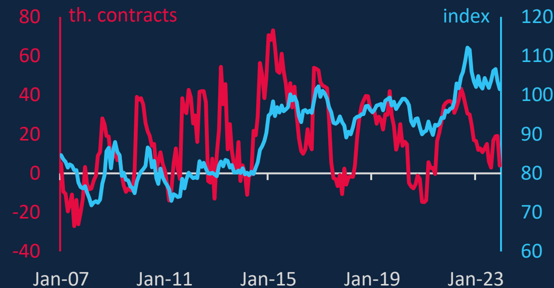
Copper



Gold



Dollar index



Note:

- The market's relative bullishness towards gold reflects expectations of a Fed policy pivot and therefore weaker USD. But the market seems less bullish on commodities as a whole, which probably shows expectations of weaker global demand in 2024.

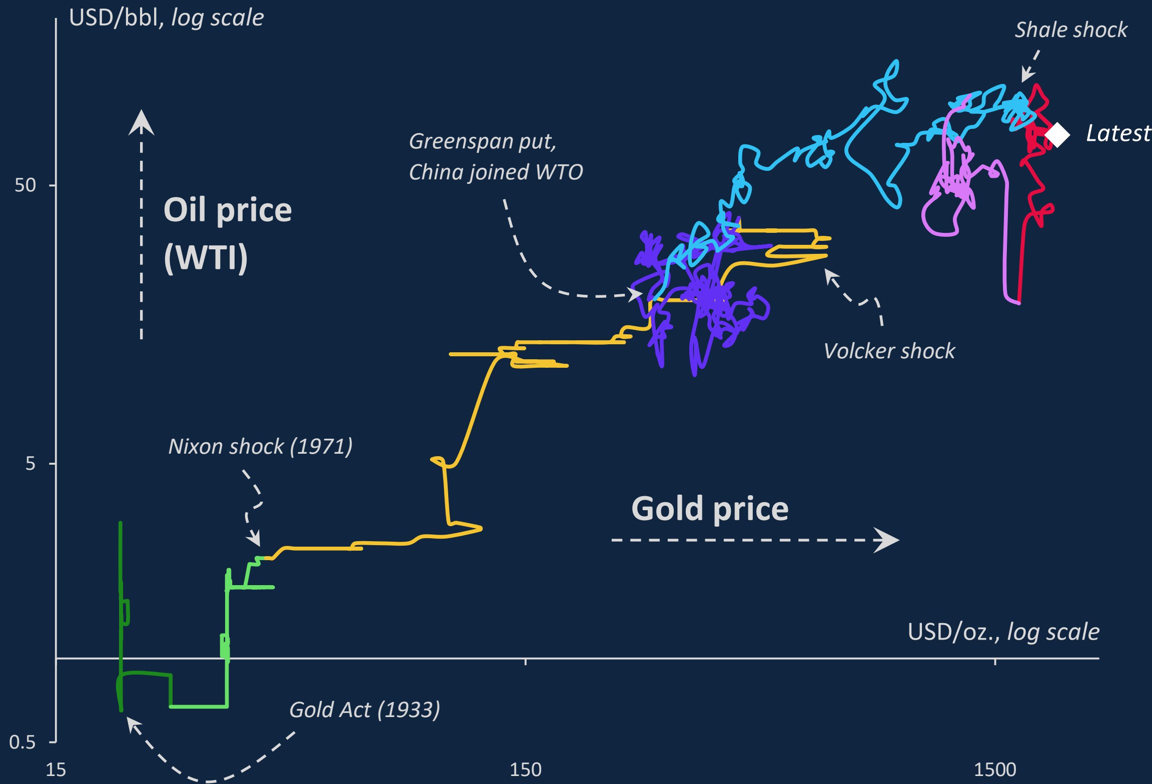
Net CFTC/NYMEX non-commercial futures position

Price level

Source: *Bloomberg, BCA Economist*

Ready for takeoff?

Without accommodative monetary policy, oil and other commodities are unlikely to go on a sustained run as in the 1930s, 1970, or 2000s



Note:

- Broadly speaking, we saw long periods of stasis where commodity prices hovers within narrow ranges, namely in 1945-71 and 1981-2002.
- These are punctuated by periods of commodity boom, monetary devaluation, and (quite often but not always) geopolitical turmoil, notably in 1933-45, 1971-81, and 2002-14.

— Classic gold standard (pre-1933)
— New Deal & Bretton Woods (1933-71)
— Oil shock (1971-81)
— Neoliberal era (1981-2002)
— Chimerica/peak oil era (2002-14)
— Shale oil era (2014-20)
— Post-pandemic (2020-?)

Source: *Bloomberg, BCA Economist*

BCA

Projections of selected commodity prices, 2024

Oil (Brent)

Our forecast range:
USD 80 – 90/bbl

	Spot	Futures*	Bloomberg**
End of 2021	77.8		
		72.5 (-6.9%)	73.0 (-6.2%)
End of 2022	85.9 (+10.5%)		
		80.7 (-6.0%)	81.3 (-5.4%)
End of 2023	77.0 (-10.3%)		
		74.4 (-3.4%)	76.1 (-1.2%)

Coal (CIF ARA)

Our forecast range:
USD 85 – 105/MT

	Spot	Futures*	Bloomberg**
End of 2021	137.6		
		90.9 (-34.0%)	100.2 (-27.2%)
End of 2022	228.4 (+66.0%)		
		183.9 (-19.5%)	184.0 (-19.4%)
End of 2023	117.6 (-10.3%)		
		96.5 (-17.9%)	97.7 (-16.9%)

CPO

Our forecast range:
USD 760 – 920/MT

	Spot	Futures*	Bloomberg**
End of 2021	1241		
		944 (-23.9%)	1060 (-14.6%)
End of 2022	947 (-23.7%)		
		913 (-3.6%)	916 (-3.3%)
End of 2023	798 (-15.7%)		
		794 (-0.5%)	798 (+0.0%)

Copper

Our forecast range:
USD 8300 – 8900/MT

	Spot	Futures*	Bloomberg**
End of 2021	9748		
		9600 (-1.5%)	9643 (-1.1%)
End of 2022	8373 (-14.1%)		
		8353 (-0.2%)	8417 (+0.5%)
End of 2023	8489 (+1.4%)		
		8648 (+1.9%)	8672 (+2.2%)

Nickel

Our forecast range:
USD 15700 – 18000/MT

	Spot	Futures*	Bloomberg**
End of 2021	20874		
		20418 (-2.2%)	20457 (-2.0%)
End of 2022	29901 (+43.2%)		
		30787 (+3.0%)	30589 (+2.3%)
End of 2023	16435 (-45.0%)		
		17393 (+5.8%)	17073 (+3.9%)

Gold

Our forecast range:
USD 2000 – 2380/oz.

	Spot	Futures*	Bloomberg**
End of 2021	1829		
		1860 (+1.7%)	1821 (-0.4%)
End of 2022	1836 (+0.4%)		
		1986 (+8.2%)	1864 (+1.5%)
End of 2023	2072 (+12.9%)		
		2244 (+8.3%)	2128 (+2.7%)

Source: *Bloomberg, projections by BCA Economist*

** futures contract for Dec-24*

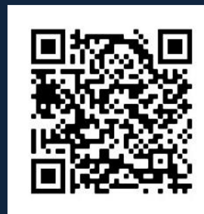
*** consensus of analysts' forecasts submitted for 2024*

Projections of macroeconomic indicators

	2019	2020	2021	2022	2023(E)	2024E
GDP growth (% YoY)	5.02	-2.07	3.69	5.32	**5.08**	**5.03**
GDP per capita (USD)	4,175	3,912	4,350	4,784	**4,982**	**5,149**
CPI inflation (% YoY)	2.59	1.68	1.87	5.51	2.61	**3.21**
BI 7-day Repo Rate (%)	5.00	3.75	3.50	5.50	6.00	**5.25**
10Y gov't debt yield (%)	7.04	5.86	6.36	6.17	6.45	**6.79**
USD/IDR exchange rate	13,866	14,050	14,262	15,568	15,397	**16,037**
Trade balance (USD Bn)	-3.3	+21.7	+33.8	+54.6	+37.0	**+32.6**
Current account balance (% of GDP)	-2.71	-0.42	+0.30	+0.98	**+0.08**	**-0.50**

Source : *BPS, BI, Bloomberg, BCA Economist estimates*

Notes:
- BI 7-day Repo Rate, 10Y yield, and USD/IDR exchange rate all refers to end of year position
- 10Y yield and USD/IDR exchange rate projections refer to fundamental values; actual market values may vary depending on market sentiment and technical factors



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