Bubble, bubble – toil and trouble?

15 February 2011

Facilitating debate on the outlook for the markets
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Determinants of Commodity Demand

- When thinking about demand for many commodities, there are two main components.

- Global Industrial Production provides a good proxy for demand for commodities used to make goods.

- Global Fixed Asset Investment is a good proxy for demand for commodities used in the construction process.

- In addition the impact on price is a function of both the level of demand and the rate of change.
Contrary to most commentary – which focuses on US GDP - the level of Global IP is back above Trend…

Source: Credit Suisse
As is the level of Global FAI…

Source: Credit Suisse
Which means that demand for basic materials is now also well above trend – i.e., markets are really tight

Source: Credit Suisse
Growth is also above average – for Global Industrial Production

Source: Credit Suisse Global Strategy
With a Global Rebalancing Under way

Source: Credit Suisse Global Strategy
Global Real Fixed Asset Investment Is Also Growing Strongly

Source: Credit Suisse Global Strategy
While the pace of Chinese investment growth has slowed from the surge in 2009, it remains around average.

This is remarkable given the now higher base.

Discussions with Chinese infrastructure firms suggest that investment will continue to grow next year.

Source: the BLOOMBERG PROFESSIONAL™ service, NBS
Iron Ore

- Despite the energy restrictions in China, iron ore prices have increased substantially over recent months.
- While global steel production is rebounding, so is supply.
- If Karnataka drops the export ban, prices may be near a peak.

Source: the BLOOMBERG PROFESSIONAL™ service
Thermal Coal Prices have also moved significantly higher over recent weeks.

The most recent spike is related to the Australian Floods.

Prices have probably peaked, but the risk of more bad weather remains.

But further out the outlook does not look as strong as for some other commodities.

Source: the BLOOMBERG PROFESSIONAL™ service
Base metals have performed strongly since mid 2010, with copper remaining our favorite buy, despite hitting new highs.

Demand is likely to outstrip supply next year, with inventories already depressed – particularly those held by end consumers.

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, WBMS
Grains: The Long Run Downward Trend May be Coming to an End

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, Global Financial Data
The Implications of What Looks Like a Structural Change in Global Relative Prices will Have Profound Implications For Aus…….
The Terms of Trade is currently at an Historical High

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, WBMS
So it is not Surprising that Mining Investment is Also Really Strong

Mining Investment as a Share of GDP (percentage points)

01/01/1861 01/01/1891 01/01/1921 01/01/1951 01/01/1981 01/01/2011

0 0.5 1 1.5 2 2.5 3 3.5 4 4.5 5

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, WBMS
But it About to Get MUCH Bigger – led by LNG

Mining Investment as a Share of GDP
(percentage points)

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, WBMS
But There is Little Spare Capacity
So For Mining Related Industries to Grow Above Average, Others will have to Grow Slower.

The Mechanism Will Be Higher Interest Rates and Exchange Rate.
Sectors Exposed to Interest Rates Will on Average Struggle – Retail is an obvious example

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, WBMS
And those Influenced By the Dollar will also be Challenged…

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, WBMS
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