IN THE SPOTLIGHT

COVID-19 Takes Commodity Prices on a Roller Coaster Ride

Leaving few stones unturned, COVID-19 has changed both the economy and our very way of life. Commodity prices are no exception. Why did commodity prices react as they did this year, and how can we use those clues to help us ascertain what the future holds?

First Half of 2020 a Commodity Price Roller Coaster
Generally speaking, the prices of most commodities moved in the same direction in the first half of the year: lower, into April, as economies shut down, then higher as economies reopened and demand increased. The degree to which prices fell and subsequently recovered, however, varies substantially. From the end of 2019 through April, steel scrap prices fell 9.9%. They then rose 10.3% over the following two months. The volatility was slightly more dramatic in aluminum (18.9% decline, then 9.7% rise) and copper (16.2% decline; 16.4% rise), but both of these pale in comparison to oil (69.1% decline; 108.4% rise).

Why? Supply and demand. With declining manufacturing activity, steel scrap -- a byproduct of that activity -- has been relatively scarce. Low economic demand plus limited supply is resulting in minimal price movement. Meanwhile, oil demand plummeted as cars were suddenly off the road with the stay-at-home orders. In the immediate aftermath of the shutdowns, that supply-demand imbalance was exacerbated by Russia and Saudi Arabia's failure to agree to coordinated OPEC+ production cuts. Copper and aluminum prices, due to those metals' relatively wide usage across a range of industries, experienced a downturn somewhere in the middle, more in line with the overall economy.

What does this mean for commodity prices for the rest of 2020 and into 2021?
A rising tide lifts all (or at least most) boats. As we move closer toward the expected recovery trend in US industrial production next year, you can expect that demand will improve, barring a widespread secondary set of shutdowns. With demand up, the prices of many commodities will have a tendency to move higher heading into next year.

READERS' FORUM

I've been wondering how the economic changes will impact the commercial and residential construction markets. What can you tell me about the future for these segments?

On a big-picture level, generally stronger market conditions are expected on the residential side. US new homes sold during the three months through May were down a relatively mild 5.9% from the same three months in 2019. There was a double-digit decline in April and May US housing permits versus year-ago levels, so decline in US housing starts is likely to extend through at least the remainder of this year. However the very low mortgage rates and high personal savings rate bode well for the residential market next year, particularly the single-family market.

On the commercial side, the US total value of commercial construction starts in the three months through May was down a whopping 74.0% relative to those months in 2019. One area that may outperform the whole is warehouse space, which has been buoyed by robust online spending as consumers adopt socially-distant shopping behaviors. Put-in-place spending growth on warehouse construction is accelerating, with a double-digit year-over-year rise in monthly spending for seven consecutive months.

A Closer Look: The US Economy

What you need to know: *A late-2020 recovery is contingent upon certain potentialities.*

As we enter the dog days of summer, it's time to outline some stakes in the ground to keep an eye on, as they could make or break the expected late-2020 recovery onset that some economists expect for US real gross domestic product (GDP):

- The first triggering mechanism that could undermine a late-2020 economic recovery is the most intuitive and perhaps the most concerning right now: governors making decisions to re-engage shutdowns across their respective states. In the face of surging confirmed COVID-19 cases, this possibility has been increasing in likelihood in recent weeks. Marquee states such as California, Texas, and Florida (among others) have tapped the brakes on their economic re-mobilization and are even re-shuttering certain entertainment and dining segments of their economies. As of now, the pauses in reopening have not yet reached the "critical mass" that would drive a downward revision to the forecast. Should we see several economically relevant states impose restrictions that go beyond targeted closures, we could lose this stake.

- The second stake is similar, but the federal government would be the actor that would force states to slow their reopening. The Trump administration has given little indication that it wants to impede states in their efforts to open up and re-energize the economy, so this does not seem probable. However, there are other ways the federal government could hinder recovery. Unproductive policy measures intended to help the economy could actually hamper it. Some possibilities that come to mind include more protectionist policies and tariffs or additional CARES Act add-ons that further intervene in labor markets, making it harder for firms to rehire as economic activity picks up in the second half of the year.

- The retail segment needs to maintain its recovery through the second half of this year. The US economy is driven and dominated by the US consumer, and most retail metrics spent May and June crawling out of the smoldering wreckage that was April. Consumers' inability to consume while states were closed drove the onset of the recession. Consumers need to go out and spend in the third and fourth quarters of 2020 to lift the economy to bluer skies heading into next year.

- Finally, US single-family housing starts must move into a recovery trend in the second half of this year. Residential housing is an important segment in the US economy and serves as a leading indicator for it as well. Fortunately, this required recovery trend is already forming: Housing starts and the National Association of Home Builders' Housing Market Index posted encouraging jumps in May and June, healing some of the damage done in April.

A stumble for any and each of these trends would suggest an added increment of downside risk to the forecast of GDP recovery beginning late this year.

INDUSTRY SNAPSHOTS

Arrows indicate 12-month moving total/average direction

Retail Sales

- June US retail sales $530.4 billion, up 2.3% from 2019; sharp turnaround from 19.4% decline from April 2019 to 2020
- Auto & other motor vehicles up 9.4% YovY; non-store retail up 30.2%,
- Extended shutdowns could have negative impact in the near term

Rotary Rig

- US rotary rig count avg. 396 rigs in Q2, down 60.0% from Q2 2019
- Oil prices ~$40/barrel recently; price below break-even for new drilling
- US oil & gas extraction production to decline due to low prices into mid-2021

Wholesale Trade

- US total wholesale trade in May down 3.5% from 1-year ago
- Up slightly from April, monthly Durable and nondurable goods down double-digit percentages over May 2019
- Total wholesale trade likely to decline into early 2021

Capital Goods

- US nondefense capital goods new orders in May rose from April, but 7.3% below May 2019 level
- Annual nondefense new orders likely to decline into early 2021
- New orders lower in May, but analysis positioned to rise

Auto Production

- N. America light vehicle production increased, still 83.2% below May 2019
- Annual production likely to decline into early 2021
- US auto & light vehicle capacity utilization rate rose from record lows to weak but normal 63.1% in June, signaling nascent industry stabilization

Nonresidential Construction

- US total nonresidential construction rose in Feb, up 3.3% from 2019
- Construction expected to decline as projects are deemed nonessential or face supply chain disruptions
- Expect decline to extend into at least early 2021

Manufacturing

- Monthly US total manufacturing production 9.1% above May, but 11.1% below June 2019
- Monthly US ISM PMI & JP Morgan Global PMI suggest upward momentum starting early 2021

Residential construction

- May US total residential construction up 4.6% over 2019
- Single- & multi-unit housing starts down only single-digits over 2019
- National Association of Home Builders' Housing Market Index returned to pre-pandemic level in July

Copper Prices

Copper averaged $2.87 per pound in July 2020, up 7.3% from the same period one year ago. Prices have risen during the last four months based on economic conditions. Certain consultancies forecast stronger demand for copper in the second half of this year as economies and industries restart. However questions remain about the degree to which the economy might bounce back before the end of 2020.