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# CIO Office Viewpoint

# Even a slowing China remains key to commodity markets

Investment Solutions

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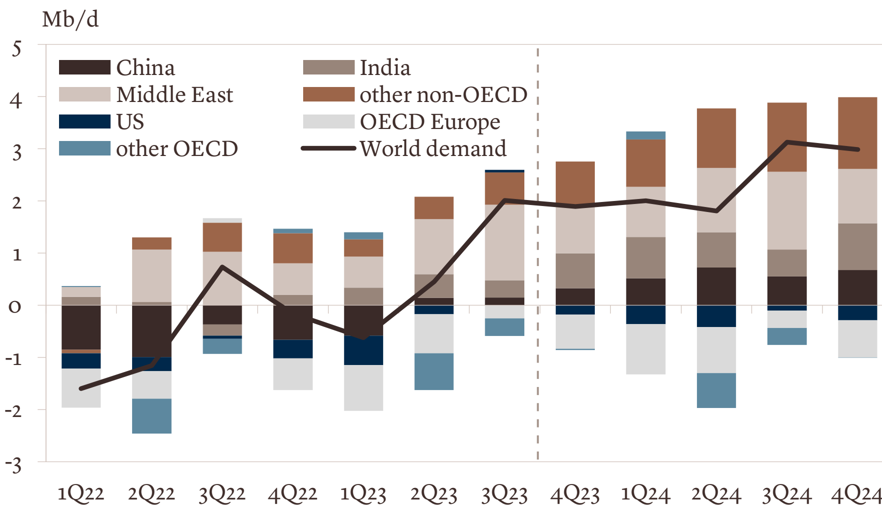
**As the world's biggest buyer of many raw materials, China's post-Covid recovery was expected to fuel commodity markets in 2023. However, its slowing momentum has overshadowed markets so far this year. Crude oil producers restricted global supplies to limit surpluses while demand for industrial copper, key to the green energy transition, has risen. We examine the importance of China's demand to the outlook for global oil markets and copper.**

Oil imports to China rose to a three-year high in June 2023, helped by government adjustments to stimulate consumption. Nevertheless, much of this was used to re-stock inventories, and did not necessarily reflect underlying economic demand, according to analysts. By some estimates, China's demand for crude may have already peaked in 2023. However, resilience in other emerging markets has largely offset the effect of slowing growth in developed economies, and taken oil demand to a record in the third quarter of 2023 (see chart 1).

Rather than demand, we believe that supply is now more influential for global oil prices. Three factors are driving global oil supplies: production cuts by the Organization of Petroleum Exporting Countries (OPEC), Russian exports, and US government reserves.

**1. Emerging market oil demand reaches record in Q3 2023**

Cumulative change in oil demand since Q4 2021




Sources: Bloomberg, Goldman Sachs, Lombard Odier calculations. Data as of 31 July 2023.

### Key takeaways

- Global oil demand has reached an historic high in 2023, helped by emerging market consumption. While China's economy has slowed, the country has re-stocked inventories and imports may have peaked
- Oil supply remains tight. The OPEC+ group of producers, including Russia, continue to support prices by reducing supply, and the US has stopped drawing on its strategic reserves
- We expect Brent crude oil to remain between USD 80-90 per barrel over the next three to six months, as restricted global supplies meet slower demand
- China's demand for industrial copper is defying its wider economic slowdown, driven by its production of electric vehicles and solar power.

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Data as of 4 September 2023 unless otherwise stated.

Starting in November 2022, OPEC+, the production cartel that includes Russia, announced a series of production cuts to support global prices. Since then, Saudi Arabia, OPEC's largest member, has unilaterally announced additional voluntary reductions and will extend these through September and possibly further. Combined, OPEC supplies have dropped to less than 30 million barrels per day, a two-year low. Coupled with rising demand, this has started to lift prices. The cost of a barrel of Brent crude has risen by almost one-fifth since 27 June, and the benchmark oil now trades around USD 88 per barrel.

## Russian price cap & US reserves

The outlook for Russian crude remains less clear. In December 2022, the US, together with other Group of Seven nations including the European Union and Australia, agreed to set a price cap on Russian crude. The agreement fixed a ceiling of USD 60 per barrel on Russian oil if sold using insurance or shipping services from one of the coalition countries. While that means Russian crude trades at a discount to other sources, it also reduces government revenues. As a result, Russia has not yet fully implemented the production cuts agreed with OPEC.

Beijing has taken advantage of Russia's lower prices and Russian supply accounted for an estimated one third of all China's fossil fuel imports, including crude oil, liquefied natural gas and coal, in July 2023. Nevertheless, the difference in price of Ural crude, Russia's benchmark oil, has narrowed against Brent notably, undermining Russian's price advantage. Last week, Russia agreed to additional production cuts, according to reports, supporting OPEC's efforts to lift prices.

The third factor affecting global oil prices is US strategic reserves. Since early 2022, the US has released an average of 450,000 barrels per day to oil markets from its government stocks. With reserves now below 350 million barrels, a four-decade low, the US government had planned to rebuild stocks. However, as world oil prices rose the Biden administration cancelled purchases designed to replenish stocks.

In the circumstances, America's ability to influence oil markets therefore looks limited. Yet there is one potential catalyst. Negotiations with Iran may eventually bring that country's oil back onto the world market. If Iranian oil were to become more available on global markets, it may add as much as four million barrels per day to supplies, and so significantly reduce prices. In anticipation of the ability to export more, Iran has already started to lift production. Here again, China's imports are setting a benchmark, and the country is paying as much as USD 10 per barrel less for Iranian oil than for Brent crude, Bloomberg reports. Iran is already thought to be exporting 1.5 million barrels per day to China, its highest volumes since at least 2013.

Where are oil prices headed, given these dynamics? While macroeconomic uncertainties in the US and Europe have kept prices within a narrow range, growth in emerging markets has proved resilient. If the global economy were to slow sharply, which is not our base case scenario, OPEC+ looks positioned to protect a price floor higher than USD 70 per barrel. As restricted global supplies meet slower demand, we now expect the price of Brent crude oil to trade in a range of USD 80-90 per barrel over the next three to six months. That would have limited inflationary effects on the global economy, since it is far lower than the highs of USD 122 per barrel reached in 2022.

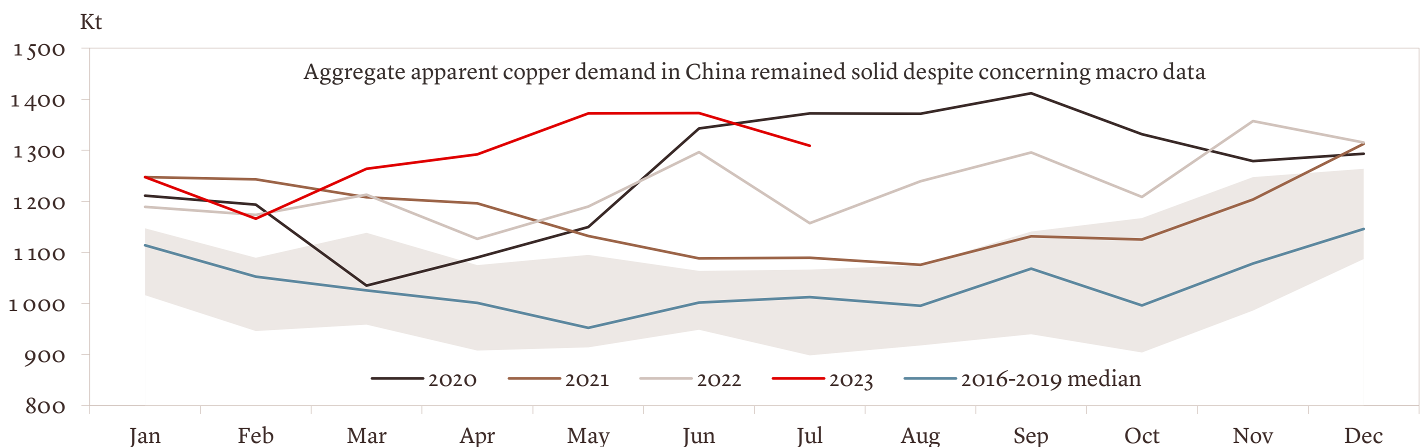
## Hard-wired into the green transition

Crude oil is not the only commodity market where Chinese demand is fundamental. China consumes a little more than half of the world's copper supplies, and is the fourth-largest producer, generating 9% of global output in 2022.

While the negative economic impacts of China's property market remain, copper consumption by the construction industry increased by 20% in July compared with the same month in 2022, thanks to policies that drove developers to complete existing work.

### 2. Copper demand in China

Chinese demand remained stable thanks to energy transition




Sources: Bloomberg, Lombard Odier calculations. Data as of 31 July 2023.

More importantly, Chinese demand for copper is also supported by the country's investments into energy independence, with a plan to reach peak carbon emissions by 2030 and net zero by 2060. That transition depends, in part, on scaling up electric vehicle (EV) production and solar power, both of which rely on copper. China became the largest exporter of cars in 2022 and is already the biggest producer of electric vehicles and batteries. Not surprisingly, demand for renewable (green) copper in July increased by 71% from a year earlier to 127,000 tonnes, according to analysts, and is now 74% higher year to date, primarily driven by surging demand for solar power.

As a result, copper is the only industrial metal with continuous inventory drawdowns in China, even as manufacturing activity slows. With China's known stocks of copper approaching record lows, the country is expected to need almost 3% more refined copper in 2023 than last year according to a recent report, and 2023's imports were around 10% higher through June, compared with a year earlier.

Although the price of copper has been flat in recent months due to macroeconomic concerns, the metal continues to enjoy firm fundamental price drivers (see chart 2). Stronger-than-expected August manufacturing data in China, along with the government relaxing restrictions in the property sector, should all provide near-term support for the industrial metal.

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