The Afreximbank African Commodity Index (AACI) Q3-2020

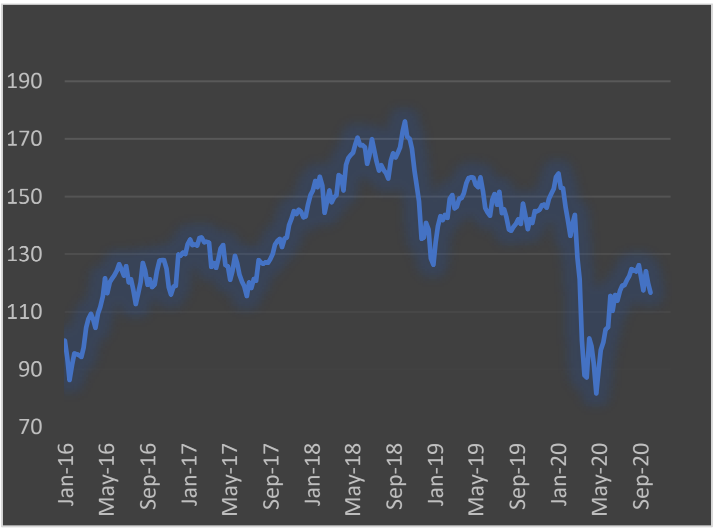
The recurrence of adverse commodity terms of trade shocks has been the bane of African economies, making it crucial for businesses and policymakers alike to consistently monitor trends in the region's key commodity markets. The Afreximbank African Commodity Index (AACI) more accurately reflects the composition of African commodities and tracks the movements of commodity prices on a quarterly basis. In so doing, the AACI highlights areas requiring pre-emptive measures by the Bank, its key stakeholders and policymakers in its member countries, as well as global institutions interested in the African market, to effectively mitigate risks associated with commodity price volatility.

The performance of the index in Q1-2020 was characterised by a sharp decline, with the *composite* value falling 44% quarter-on quarter on account of the disruptive impact of the novel coronavirus on global demand and commodity prices with oil markets bearing the brunt of the pressure, resulting in a 63% quarter-on-quarter decline in the *energy* sub-index. There were also declines for the *base metals* and *agricultural* commodities sub-indices which fell 20% and 9% respectively over the same period. In contrast, *precious metals* rose 9% quarter-on-quarter due especially to haven demand for bullion.

The trajectory of the index in Q2-2020 was upwards, with the *composite* rising 34% quarter- on-quarter, buoyed by the recovery in oil prices as indicated by the *energy* sub-index which rose 72% quarter-on-quarter. The *base metals* sub-index gained 17% quarter-on-quarter in Q2-2020, helped by the speedy recovery in China. Meanwhile, *Precious metal* prices posted a 9% gain on the quarter, a third successive quarter of gains. The sub-index, led by gold, defied the collapse in commercial travel—and the associated disruption on the gold supply chain—and the appreciation of the dollar, choosing instead to profit from potential asset price declines contingent on a drawn-out economic recovery.

Agricultural commodity prices suffered a second successive quarter of declines in Q2-2020 as gains in cotton, sugar, corn and palm oil prices were not enough to offset declines in cocoa, coffee and wheat.

Figure 1: The Afreximbank African Commodity Index



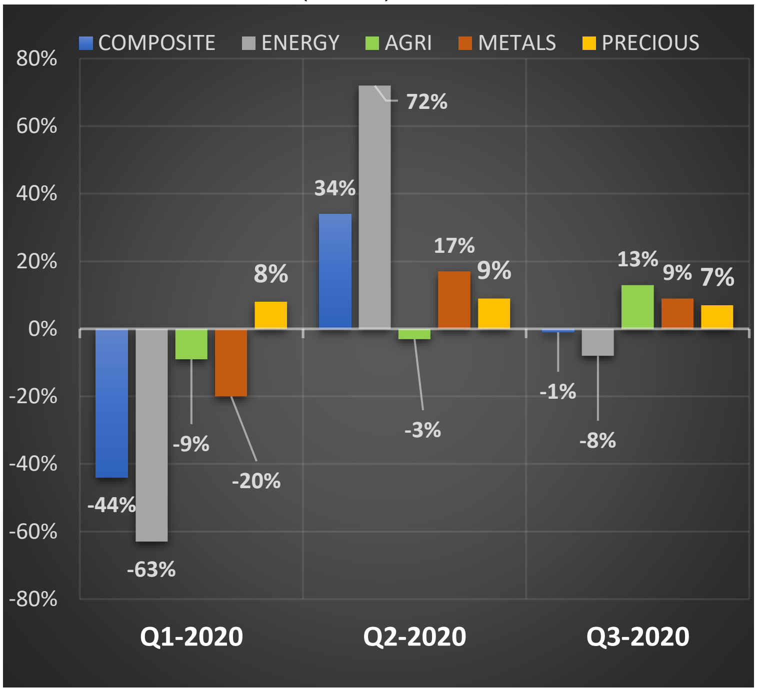
Source: Afreximbank

Q3-2020 performance

The performance of the AACI was more muted in Q3-2020, with the *composite* index falling marginally by 1 percent quarter-on-quarter. The period was marked by a pull-back in the energy sub-index while the agricultural commodities sub-index rose to become the top performer in the quarter, outstripping gains in base and precious metals.

During the period, the *energy* sub-index fell by 8% due largely to a sharp drop in oil prices in the latter part of the quarter, after markets had been inching higher for most of Q3-2020. Oil prices derived support in July and August from an increasingly positive global growth outlook as economies started to reopen following the COVID-19 lockdown. Further, poor access to Libyan crude, shrinking US oil inventories and a dent to US shale operations, including increases in the cost of capital, all contributed to lifting oil market sentiment.

Figure 2: Performance of AACI Composite and Sub-Indices, 2016-2020 (Q1-Q3)



Source: Afreximbank

However, the oil market stumbled at the start of September as Chinese demand started to wane due to a robust build-up in domestic inventories, and as Saudi Arabia cut its pricing in anticipation of the end of the summer driving season in the US against a backdrop of concerns of a second wave of the novel coronavirus in parts of the world, including in Europe.

The *agricultural commodities* index rose 13% due in part to suboptimal weather conditions in major producing countries. During the quarter, sugar prices gained on expectations of firm import demand from China and fears that Thailand's crop could shrink in 2021 following a drought. Moreover, the impact of the weaker US dollar on dollar-denominated commodities was also supportive. Cocoa futures enjoyed a pre-election premium in Ghana and Côte d'Ivoire, despite the looming risk of bumper harvests in the 2020/21 season and the decline in the price of cocoa butter. The cocoa market was also buoyed by the introduction of a US$400/tonne living income differential (LID) in Ghana and Côte d'Ivoire, aimed at improving farmer incomes.

Consequently, both countries, which account for over 60% of global cocoa output, raised their farmgate prices—by 28 % in Ghana and 21 percent in Côte d'Ivoire. The implementation of the LID comes on top of the price-supportive "country premium" for longer-dated futures which importers must now pay to access cocoa from Ghana and Côte d'Ivoire.

In the cotton market, the threat of storm Sally on the US cotton harvest, coupled with poor field conditions in the world's largest exporter contributed to buoy prices, with cotton rising to trade at its highest level since February 2020. Meanwhile, La Nina weather conditions in Vietnam, the world's largest producer of Robusta coffee, also raised the possibility of a shortage in exports in the months ahead pushing the coffee index to close the quarter 10% higher compared with its price at the start.

Base metal prices continued their recovery. After the relatively strong performance in Q2-2020 the sub-index rose 9% quarter-on-quarter in Q3-2020. Several factors converged to support base metal prices, including ongoing supply concerns for copper in Chile and Peru and strong demand in China, especially as the State Grid boosted spending to improve the power network. Customs data from China also showed that its imports of unwrought aluminum and aluminum semis soared in August partly linked to physical disruption in China's supply chains.

The *precious metals* sub-index has been the best performer year-to-date and in Q3-2020 it consolidated gains recorded since the start of 2020. The demand for haven bullion continued in the face of persistent economic challenges triggered by COVID-19 and heightening geopolitical tensions. Gold also enjoyed record inflows into gold-backed exchange traded funds (ETFs) which offset major weaknesses in jewellery demand, though the latter part of the quarter saw bearish sentiment creeping into gold markets with speculators withdrawing funds from ETFs.

Table 1: Selected commodity forecasts

	Quarterly					Annual		
	Spot	Q4-2020	Q1-2021	Q2-2021	Q3-2021	2020	2021	2022
ICE Brent, $/bbl	38	38	40	40	41	40	41	43
Aluminium, $/tonne	1,803	1,811	1,807	1,819	1,834	1,681	1,827	1,884
Cobalt, $/lb	15	15	15	16	16	14	16	17
Cocoa, $/tonne	2,319	2,339	2,337	2,331	2,329	2,432	2,331	2,333
Coffee Robusta, $/tonne	1,342	1,324	1,344	1,363	1,387	1,299	1,377	1,444
Copper, $/tonne	6,730	6,732	6,734	6,741	6,742	6,125	6,740	6,745
Corn, UScents/bu	399	398	402	405	390	362	397	393
Cotton, UScents/lb	70	70	71	72	70	64	71	69
CPO, MYR/tonne	3,252	3,173	2,933	2,766	2,658	2,726	2,750	2,655
Gold, $/oz	1,884	1,870	1,876	1,883	1,889	1,786	1,885	1,907
Sugar (raw), UScents/lb	14	14	14	13	13	13	13	12
Wheat, UScents/bu	605	604	603	597	596	548	600	590
Zinc, $/tonne	2,541	2,522	2,545	2,555	2,563	2,261	2,558	2,577

Source: Bloomberg, Afreximbank

Outlook for commodity prices

Sentiment on commodity prices is generally conservative with market consensus forecasting prices to stay within a tight range compared with current spot prices (see tables 1 and 2). Crude oil, Coffee, CPO, Cobalt and Sugar are the few exceptions to this view. Oil prices are expected to rise around 10 percent over the next year as the sector emerges from stagnation in global travel and global oil demand tethers towards pre-pandemic levels. However, the oil industry will need to clear the backlog of compensatory supply cuts that suppliers like Iraq and Nigeria owe in return for initially breaching output quotas. Cobalt prices are likely to be supported by investments in electric vehicle infrastructure.

The outlook for coffee prices is positive and is supported by extremely wet weather in top producer Vietnam, which had hitherto been threatened by extremely dry weather, which could cut output by 1 to 2 million bags. Meanwhile, crude palm oil (CPO), which has enjoyed a strong rally, is expected to revert to its mean and trade at a discount to soyoil to avoid demand destruction. In the sugar market, expectations of stronger output from Brazil—as more cane is diverted to sugar from ethanol—and tighter restrictions aimed at slowing the spread of the virus have raised concerns that demand for sugar in food and beverages will stay subdued.

Table 2: Forecasts vs Spot Prices, % Change

	Q4-2020	Q1-2021	Q2-2021	Q3-2021	2020	2021	2022
ICE Brent, $/bbl	1.6%	5.0%	7.4%	10.1%	5.3%	8.1%	13.8%
Aluminium, $/tonne	0.4%	0.2%	0.9%	1.7%	-6.8%	1.3%	4.5%
Cobalt, $/lb	2.1%	2.5%	3.3%	4.0%	-5.4%	3.6%	12.6%
Cocoa, $/tonne	0.9%	0.8%	0.5%	0.4%	4.9%	0.5%	0.6%
Coffee Robusta, $/tonne	-1.3%	0.1%	1.6%	3.4%	-3.2%	2.6%	7.6%
Copper, $/tonne	0.0%	0.1%	0.2%	0.2%	-9.0%	0.1%	0.2%
Corn, UScents/bu	-0.3%	0.8%	1.5%	-2.3%	-9.3%	-0.7%	-1.5%
Cotton, UScents/lb	-0.1%	1.7%	2.9%	0.9%	-8.6%	1.1%	-1.7%
CPO, MYR/tonne	-2.4%	-9.8%	-14.9%	-18.3%	-16.2%	-15.4%	-18.4%
Gold, $/oz	-0.7%	-0.4%	-0.1%	0.3%	-5.2%	0.1%	1.2%
Sugar (raw), UScents/lb	2.0%	-0.1%	-7.2%	-10.1%	-7.9%	-6.5%	-12.2%
Wheat, UScents/bu	-0.2%	-0.4%	-1.3%	-1.4%	-9.5%	-0.9%	-2.4%
Zinc, $/tonne	-0.7%	0.2%	0.6%	0.9%	-11.0%	0.7%	1.4%

Source: Bloomberg, Afreximbank