Real Assets: Commodities

- As China represents the bulk of global demand for industrial metals, the recent sell-off in metal prices, from copper to steel, was not unexpected.
- Previously, the fall in commodity prices was seen as driven mainly by global oversupply but here the problem is on the demand side.
- Figure 3 compares China's industrial production growth and the industrial metal price index.
- In late 2010 China's manufacturing production growth was around 15%-20% as a consequence of China's huge fiscal stimulus being channelled into investments and infrastructure, worth about 4% of GDP.
- This led to a substantial increase in building and production, contributing to a real estate overheating. When the correction started in 2012, economic growth in China fell and led to a downtrend in industrial metal prices.
- To end the decline in industrial metals prices, we therefore might need both a reduction of supply and an increase in demand (from China in particular).

Figure 3: Industrial metals prices and Chinese industrial production
Source: Bloomberg Finance L P, Deutsche AWM.
Data as of September 30, 2015

Focus of the week

Commodities: Industrial metals prices are likely to remain closely tied to the state of China's economy.

Global FX: We expect EUR strength to continue to be affected by the level of ECB bond purchase activity.

Global FX

- When a good is seen as increasing in supply, normally its price goes down as its scarcity reduces. The same is true for the EUR.
- When the ECB signalled (about a year ago) its readiness to increase the supply of EUR via the driving its balance sheet size yet higher, markets logically started to anticipate a lower EUR.
- The increase in the ECB balance sheet has stalled in the last two months due to a slowdown in the buying of bonds by the ECB. This was mainly a function of less liquid bond markets in the summer lull, which has now ended.
- The latest comments of the ECB's president in the press conference after its meeting point to a clear ECB bias to be ready to expand or prolong its QE if needed. The only question is when and here markets are getting more impatient.
- If the ECB does indeed push QE into a higher gear, this could weaken the EUR, as Figure 4 suggests.

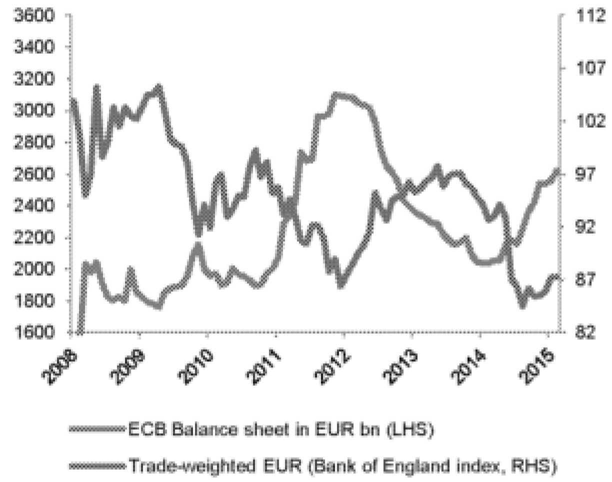

Figure 4: The EUR and the ECB's balance sheet
Source: Bloomberg Finance L P, Deutsche AWM.
Data as of September 30, 2015.