Is Bad News in China Good News for Commodities?

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Craig Botham, Emerging Markets Economist at Schroders, comments on the effect that the slowdown in China may have on commodities *:

"China's slowdown has prompted hopes of stimulus and optimism for commodities but this is misplaced. The nature of the current slowdown and the rebalancing of growth mean we are likely to see less of a lift than in the past.

China's economy expanded 7.4% in 2014, missing the government's 7.5% target and while most people expect further government stimulus in 2015, less unanimous is what the market impact of any stimulus might be on commodities. While we don't see agricultural commodities as being much affected because demand is driven by population growth rather than economic growth, there is some evidence that metals prices should benefit. This is largely because the government's new stimulus is set to take the form of infrastructure investment and some monetary easing. Research suggests that there is a lagged effect from infrastructure on metals prices although, in fact, real estate investment is much more commodity intensive. The government's infrastructure spending plans should therefore provide some support to metals demand and prices, although this is likely to be offset by continued weakness in property investment as the property market slowdown persists in 2015.

Looking at the effect of monetary easing, we see that an expansion of money supply seems to be associated with strong metals prices as it boosts the supply of credit for investment. However, it is apparent that the relationship between money supply growth and property investment has broken down over the course of last year as a slowing property market and falling land values has seen declines in both demand and supply of credit in the sector. So we do not, therefore, expect monetary easing to have much impact on infrastructure investment or commodity prices.

It is also worth pointing out that it is extremely unlikely that Chinese stimulus would provide a boost to oil, particularly given that the role of oil in Chinese growth has been declining steadily since at least the 1980s, displaying no relationship with the investment cycle.

A China-driven renaissance for commodities, based on current stimulus plans, is not in the offing."

* Please see the attached for the full article

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