Goldman Sachs Exchanges

Commodities Outlook: What's Driving Oil, Gold, and Base Metals

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Allison Nathan: Geopolitical tensions, trade policies, and a slowing economy are driving significant volatility across gold, oil, and other commodities. So, what's the outlook from here? I'm Allison Nathan, and this is Goldman Sachs Exchanges. For today's episode, I'm speaking with my colleague in Goldman Sachs Research, Daan Struyven, co-head of Global Commodities Research and head of Oil Research, to talk about how recent events, notably the Middle East conflict and evolving tariff policies, are affecting the broader commodity and economic landscape. Daan, welcome back to the program.

Daan Struyven: Thanks, Allison.

Allison Nathan: So, let's start with oil. I think the obvious place to start. Oil prices have been very volatile amid these recent developments in the Middle East, but I think what's most striking to me is how quickly they actually retreated from the recent highs. And they're still at lower levels than I think many people would have expected given the recent developments. So why is this?

Daan Struyven: Yeah, absolutely. So we estimate that the geopolitical risk premium in oil spiked to over $15 per barrel on Sunday night, just a week ago. And then 24 hours later, it was just worth only a couple of dollars per barrel, based on the fact that oil prices were nearly back to pre-escalation levels and also if you look at options markets. If you look at options markets and look at the probability of large supply disruptions, pretty low, as estimated by options markets. Below 4% or so.

And the question is: Why is that? I think the first reason is that oil traders have now experienced several episodes with major geopolitical shocks with actual no disruptions to oil flows, with barrels still flowing. I think the second reason is that Iran's response was quite muted. Both the US and Qatar got a heads up and there were no damages.

Third, I think both the US and China have very big incentives to make sure that oil flows continue, in particularly through the Strait of Hormuz. And President Trump, with his great focus on energy affordability in particular, he's super focused on preventing those disruptions. And then last but not least, I think a lot of traders are reluctant to position for sharp price upside as they share a view that the markets will start to see large inventory builds from the fall onwards.

Allison Nathan: Right. So, a lot of forces working in the opposite direction. But just to be clear, if we were to see an escalation of tensions, what would the upside look like?

Daan Struyven: Yeah, so the last few weeks are a reminder that geopolitics can cause potentially very significant price upside if we were to see actual disruptions. To be clear, our base case assumes no disruptions, but we estimate that crude could spike above $90 per barrel if Iran's supply were to drop sharply. And in an extreme tail scenario where the Strait of Hormuz were to be disrupted for a sustained basis, oil prices could spike above $110 per barrel. To be clear, we think these are tail scenarios. But, yeah, geopolitical situations currently are not necessarily in a stable equilibrium, so we'll keep watching the geopolitical risks.

Allison Nathan: Right. So that is the upside tale. Upside in terms of prices. Maybe downside in terms of the global economy. But even beyond that really extreme scenario, do you see any lasting consequences from what has ultimately been this 12-day war in terms of the commodity markets?

Daan Struyven: I think it was definitely scary for investors and policymakers going through it. At some point, if you looked at the Polymarket prediction market, the probability of a disruption of the Strait of Hormuz spiked to 60% at some point. And I do think that policymakers, especially in China, will likely double down on diversifying their supply of energy. In practice, that means good thing to invest in power, electrifying the economy, coal as well. Basically, boost the supply of everything that you have at home.

China continues to import about two thirds of its oil consumption from the rest of the world, and about 50% of its imports are coming from the strait. So I think this is going to strengthen this key trend of diversifying away from foreign oil and gas imports for the Chinese economy, which is bearish oil and gas but bullish for copper and some of the other green metals.

Allison Nathan: And in general, if you think about the prospect of a big disruption, are you seeing oil producers broadly looking to increase supplies that were not as vulnerable? We've already seen that trend, have we not? I mean, what are you observing in terms of the oil supply trends amid these types of developments?

Daan Struyven: Yeah, so the main reason we look for oil prices to drop by another $10 per barrel over the next year is that we expect strong supply growth. In fact, we expect global supply this year to grow four times more quickly than demand, assuming no disruptions, with strong supply growth basically from two buckets of countries -- the OPEC-plus producers that are unwinding their voluntary production cuts and then what we call non-OPEC, ex-US shale countries such as Brazil, Guyana, Norway, Kazakhstan, that are actually raising production by a million barrels per day between August and last month. So very rapid supply increases there.

And there's actually I think upside risk to our forecast that US shale supply will decline modestly. Our base case looks for declines because we look for lower prices, but the recent spike I think has allowed many producers to sell forward their production at a higher price, to hedge price risk. And when we speak to some of the producers, they're a little bit less pessimistic about the oil price outlook from their perspective than, for instance, in early April. And in fact, we got an all-time high for US crude supply released earlier today for the month of April. So, I think this reinforces our view that supply growth will be strong and will push down oil prices, assuming you get no geopolitical surprise.

Allison Nathan: Well, I was just going to ask you about that because, relative to the last decade, oil prices aren't particularly high right now, but producers are saying they're somewhat optimistic. They've hedged at slightly higher prices. And so ultimately, this price is economic to motivate the supply growth you're seeing.

Daan Struyven: Yeah. So we expect supply growth global this year to be driven by long cycle producers that have very low variable costs in contrast to US shale where the variable costs are quite high and where we look for modest declines perhaps with the risk of flat production based on the recently stronger numbers. The big picture of the last ten years have been an era where US shale has driven 100% of global supply growth, and I think our forecast is that '25 and '26 are going to be a partial, but only very partial, reversal of that trend. But US shale supply declining modestly because we expect lower prices. And with countries such as Saudi Arabia and the UAE regaining market share.

Allison Nathan: So supply substantially outpacing demand, but let's talk a little bit more about demand because one of the other striking aspects of the last few weeks has been the incredible heat wave that we've been experiencing here in the US as well as in Europe. What are the implications of that on demand?

Daan Struyven: Yeah, so the heat waves we are experiencing in the US, in Europe, now in China are bullish for energy prices, both because it means higher cooling demands via AC and because it could also potentially disrupt supply of some of the oil refined products, for instance. It can be tough for refineries to run with those very hot temperatures.

We think that the most significant upside is in power prices, including summer big power prices in the US. And to a lesser extent, it could be also be positive for natural gas prices or coal prices. And to a lesser extent, fuel oil, which is the part of the oil barrel that is used for cooling.

We do think that US summer power markets are getting very tight. And following the blackout we see in late April in Spain, we do think that some of the tighter US power markets -- for instance, the mid-Atlantic market -- is at the significant risk of power price spikes and perhaps even outages. The reason is that power demand is now growing quickly, more quickly than GDP, in sharp contrast with the last two decades. Data centers are part of that. And on the supply side, most of the supply growth is really coming from weather-dependent supply such as solar and wind, and we're also having a lot of coal retirements being scuttled. So in other words, the summer power market is getting critically tight, and we do think that outages are a significant risk.

Allison Nathan: Interesting. And we think about beyond these weather-related risks, we're entering the summer travel season here in the US in particular. How does that impact demand? Again, it's interesting to me that demand is falling so far behind supply.

Daan Struyven: Yeah, so seasonally, oil demand is going to be strong in July and August. Those tend to be the strongest months both because of cooling demand and because of travel demand. But taking a step back from the seasonals, I would characterize oil demand growth as pretty modest compared to history and modest compared to strong demand growth were seeing in some of the other commodities like copper. So specifically, we expect global oil demand to grow by 600 KBD this year. That is 0.6% of the overall market. Contrast that with the 4-5% demand growth we see in global power markets. Compare it with copper demand in China that's up 25% year to date with surges in solar installations and electrification supporting demand. So, I think divergence is a key theme that we're seeing, especially within China commodity markets, but more broadly on the demand side across the markets.

Allison Nathan: But economic growth it’s slowing, as I said at the beginning but it's still holding up relatively well.

So why are we seeing such subdued growth for oil? Is it just becoming less energy-intensive growth?

Daan Struyven: Yes. I think traditionally GDP growth was maybe 1.5 percentage points faster than oil demand growth as, for instance, vehicles became more fuel efficient. But we do think that oil demand in China has peaked. China oil demand used to grow by 500, 600 KBD in the five years before the pandemic. But the very rapid shifting out of gasoline and diesel into electric-powered cars, into LNG-powered trucks, and now even into electric trucks is causing China oil demand to stagnate and is now causing a wider gap between GDP growth and global oil demand growth. Perhaps the new normal for that gap is around 2.5 percentage points or so.

Allison Nathan: Interesting. Let's pivot a little bit and talk about the other commodity that's gotten a lot of attention, been a big outperformer this year: Gold. Gains have recently consolidated, but gold prices are still up 25% year to date. Are you still bullish gold? And if so, why? Is this a cyclical story? It's a structural story? What's driving the bullishness?

Daan Struyven: Yeah, we're still bullish. We still expect the gold price to rise to $4,000 per troy ounce, so that's another 20% of upside for here. The main reason is really structurally higher demand from central banks. Central bank buying of gold has increased five-fold since '22 when Russia's central bank reserves got frozen. And we just got the survey a couple of months ago surveying more than 70 central banks across the world, and the survey showed record high purchase intentions with no central bank that was surveyed indicating that they would reduce their gold holdings over the next 12 months.

Allison Nathan: So interesting. So, it's central banks diversifying, and they're diversifying out of the dollar, right? Or where are they diversifying from? Dollar-based assets?

Daan Struyven: Yes, primarily. Yeah.

Allison Nathan: And that's interesting because if we think about a structurally weaker dollar and lower interest rates ahead, which I think is the consensus expectations and certainly our expectations, particularly on the dollar side, what does that mean for commodities demand for gold but even beyond?

Daan Struyven: Yeah, so I think the big potential winner from further dollar diversification is gold. But more broadly, I think the industrial metals could benefit from lower rates and a weaker dollar.

On gold specifically, the almost doubling in price since '22 has really been driven by central banks diversifying out of the dollar. But the next giant leap for gold markets could be private investors, who often feel like they're overallocated to the dollar, may reallocate to some extent out of dollar holdings into gold, and that could be the next giant leap for gold markets because the gold market is 200 times smaller than the US S&P 500. It's 100 times smaller than the US treasury market. So, you only need, like, a very small shift of flows into the much smaller gold market to cause very significant gold price upside.

More broadly, I think to know which commodity would benefit from lower rates and a weaker dollar, I think you have to think about the drivers. Are you in a risk-off environment where the dollar and rates are weakening because market participants are worried about US recession or about US fiscal sustainability? Then I think gold is your winner. If you're more in a risk-on environment where the dollar is perhaps weakening because of European stimulus or perhaps because you see a dovish pivot in the Fed reaction function, then we find typically that industrial metals such as copper and aluminum are the biggest winners.

Allison Nathan: Okay. Lots to think about there. The other big wild cards of course out there right now are trade uncertainty and fiscal uncertainty. We are still facing this looming July 9th tariff deadline. Been a lot of back and forth about what will happen on, before, even after that date. So how are tariffs reshaping the commodities landscape? Where do you stand now in terms of their impact on prices ahead?

Daan Struyven: Yeah, so I think I want to distinguish between the macro impact from higher tariffs on other things than commodities -- for instance, the reciprocal tariffs -- on GDP commodity demand and commodity prices, and then the impact of tariffs on metals specifically.

So far, I think the macro impact via weaker GDP of tariffs is still not very large based on what we can see. Still manageable. Perhaps because financial conditions have weathered the tariffs in position well. Perhaps because trade policy uncertainty measures are normalizing. But perhaps because it's still too early to see the full effect. I think there has been a lot of frontloading that may have postponed the hit from tariffs to the GDP growth and therefore commodity demand.

What is already very clear, though, is the impact of the tariffs on metals, on metals markets. In particular, we have a 50% tariff on steel, a 50% tariff on aluminum imports, and we expect a 25% tariff on copper markets. So far, we are seeing pretty significant price increases for US steel and US aluminum, so these tariffs are leading to significantly higher prices. And we do think that the possibility of a 25% tariff, perhaps a 50% tariff, on US copper imports is providing opportunities for investors because what traders are now trying to do is they're trying to get the metals shipped into the US before the potential deadline, and that's leading to very significant tightness in the rest of the world. Inventory levels in places like China and the world excluding the US have fallen to only 10 days' worth of consumption, so that's putting a lot of upward pressure on prices outside of the US. And so we do think that the threat of tariffs on copper is causing price upside both in the US mechanically because people will have to pay for the tariff but also outside of the US.

Allison Nathan: Right. But that's a pretty temporary phenomenon. You'd expect that eventually to play out.

Daan Struyven: That's right. That's right.

Allison Nathan: And if we think about the other major development that I mentioned, the fiscal deficits, both in the US and then in Europe as we see this increase in defense spending, maybe a welcome increase, what are the implications of that for commodities?

Daan Struyven: Yeah, I may sound like a broken record but again metals feel like the winners of these meta trends as opposed to energy. On fiscal specifically, if markets were to become more concerned again about US fiscal sustainability, perhaps if the being beautiful bill gets approved, we think gold would be the winner. What we have seen over the last two months is a very positive correlation between a long-dated US yield -- the 30-year treasury yield on the one hand -- and the gold price. So, periods when the market gets worried about US sustainability or periods where rates go up and the gold price rises.

Defense specifically, the industrial metals should benefit. The data are a little hard to get, but a report from the defense department showed that about 5% of US copper demand is driven by the defense industry, so sizable share, and 13% of nickel demand. So we do think that industrial metals, especially nickel, are well positioned to benefit from a structurally higher level of defense spending.

Allison Nathan: How much of that, though, is already priced in? We've been talking about this for a while, so you'd imagine that traders would be positioned for this to some extent already.

Daan Struyven: Yes, although commodities tend to be more spot assets and less forward looking than equities. And also, second, these are pretty long-lasting trends. I think the main takeaway from the NATO summit in The Hague last week was that, yes, Europe plans to go to 3.5, perhaps even 5% of defense spending as a share of GDP but it will take a while.

Allison Nathan: So then putting this all together, how would you think about the relative upside of various commodities heading into the second half of the year?

Daan Struyven: We see the most upside for gold and for US copper and see the most downside for oil. We see the most upside for gold because of structurally higher central bank demand for gold, and it's also a great hedge against several of the key risks including tariff escalation or concerns about US fiscal sustainability. We also see significant upside to US copper prices because the copper market is currently pricing at only a 15% tariff on US copper imports and our base case is 25% with risk skewed towards a 50% tariff on copper. Finally, we see the most downside to oil prices. Base case, another $10 per barrel lower over the next 12 months because of very strong supply growth, and it could go even lower if OPEC were to raise production more than our base case.

Allison Nathan: I have to say it again, it is so striking to me that given everything that has evolved with the Middle East that oil has the least upside here, but you make a very convincing case. Thanks so much for joining us, Daan.

Daan Struyven: Thanks a lot, Allison.

Allison Nathan: This episode of Goldman Sachs Exchanges was recorded on Monday, June 30th. I'm Allison Nathan. Thanks for listening.

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