Commodity strength collides with higher interest rates

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Commodities are complicating the inflation fight: Renewed strength across energy and agriculture is keeping inflation pressures elevated just as Fed Chair Kevin Warsh’s hawkish Jackson Hole speech has revived expectations for further US monetary tightening.

Global bond yields are flashing monetary and fiscal warnings: The US yield curve has bear-steepened, with the 10-year Treasury yield above 4.75%, while German and Japanese yields have reached multi-decade highs amid concerns about inflation, heavy government borrowing and debt sustainability.

Investment metals face a three-pronged headwind: Gold and silver have corrected lower as higher rate expectations, rising yields and a stronger dollar weigh on demand, although longer-term support from fiscal concerns, debasement risks and central-bank buying remains intact.

Industrial metals continue to defy macro headwinds: Supply tightness is partly offsetting the stronger dollar and higher borrowing costs, with zinc reaching a four-year high while copper holds firm near record levels.

Global markets have entered September facing an increasingly uncomfortable combination of rising commodity prices, sticky inflation, higher interest-rate expectations and concerns about government debt sustainability. Commodities sit near the centre of this tension, with renewed strength across energy and agriculture adding to inflation pressures just as central banks signal borrowing costs may need to remain elevated, or even rise further.

The shift accelerated following Federal Reserve Chair Kevin Warsh's hawkish Jackson Hole speech on Friday. His renewed focus on restoring price stability prompted markets to increase expectations for further monetary tightening, pushing US yields and the dollar higher.

The move has since broadened beyond the immediate repricing of Fed policy. The US Treasury curve has bear-steepened, with the 10-year yield reaching 4.79%, its highest since January 2025. The selloff has also become global, with Germany's 10-year Bund yield reaching a 15-year high above 3.35%, while Japan's equivalent has reached 3% for the first time in more than three decades.

At the front end, higher yields primarily reflect expectations for tighter monetary policy. Further out, investors are also demanding increased compensation for inflation uncertainty, heavy sovereign issuance and mounting fiscal risks. With US government debt having reached USD 40 trillion, rising borrowing costs risk becoming an increasingly important part of the macroeconomic story.

Tighter financial conditions have so far done little to contain several of the commodity markets contributing most directly to inflation. Since Jackson Hole, the Bloomberg Commodity Total Return Index has risen further, led by energy, grains and soft commodities, while precious metals have fallen. Put simply, the commodities creating the inflation problem have continued higher, while those traditionally bought to protect against its consequences have retreated.

Energy remains the most immediate source of pressure. Crude oil has risen for a second session after renewed US-Iran hostilities raised concerns about prolonged disruptions to flows through the Strait of Hormuz. Brent has moved back above USD 92 per barrel, while already tight refined-product markets remain particularly exposed.

In Europe, gasoil futures, the benchmark for diesel and jet fuel, trade above USD 183 per barrel, while natural gas has reached EUR 71.5/MWh, equivalent to roughly USD 24.3/MMBtu and more than eight times the US price. These elevated costs highlight Europe's continued dependence on imported energy and vulnerability to supply disruptions.

Diesel's inflation impact extends well beyond transport into freight, agriculture, mining, construction and industrial production, while expensive natural gas raises electricity and manufacturing costs. This represents a supply-driven inflation shock that monetary policy cannot directly resolve. Central banks can suppress demand, but they cannot produce additional crude oil, refining capacity or natural gas. In simple terms, the commodities creating the inflation problem have continued higher, while the commodities traditionally bought to protect against its consequences have fallen.

The Bloomberg Commodity Agriculture Total Return Index ended August at a 14-year high after surging 12.4% during the month. Strong gains across grains and soft commodities, led by sugar, wheat and corn, more than offset weakness in livestock. Weather disruptions are affecting crops around the world, while renewed fighting between Russia and Ukraine has targeted critical export infrastructure around the Black Sea. With the region accounting for more than a quarter of global wheat exports, supply concerns have helped lift wheat prices towards a three-year high.

Unlike energy, where higher prices feed relatively quickly into headline inflation, rising agricultural costs often take longer to reach consumers through processing, transportation and retail channels. The latest rally therefore raises the risk that food inflation remains elevated even if energy prices eventually stabilise. Together, energy and agriculture leave central banks facing a difficult trade-off: inflation is being supported by supply constraints and geopolitical disruption, while tighter monetary policy risks putting additional pressure on economic activity and already stretched government finances.

Precious metals have taken the brunt of the monetary repricing. Gold and silver have both fallen by more than 4% since Friday as Warsh's speech produced three immediate headwinds: higher short-term rate expectations, rising real and nominal yields, and a stronger US dollar.

The dollar has retained much of its post-Jackson Hole strength, while breaks below key technical support levels have triggered additional long liquidation from momentum-focused traders. Higher yields increase the opportunity cost of holding non-interest-bearing assets, while a stronger dollar raises their cost for non-US investors.

However, the longer-term implications are less straightforward. Higher real rates driven by a credible inflation-fighting central bank are normally negative for gold. Higher long-term yields increasingly driven by concerns about debt sustainability, heavy sovereign issuance and fiscal credibility are a different matter.

Persistently rising debt-servicing costs may eventually increase pressure on policymakers to prevent long-term borrowing costs from rising indefinitely. Gold therefore remains caught between two opposing forces: the immediate cost of money and longer-term concerns about the quantity and credibility of money. Continued central-bank demand and reserve diversification provide another structural source of support that is less sensitive to short-term changes in US rates.

Interestingly, weakness in investment metals has not spread meaningfully to industrial metals. Ordinarily, a stronger dollar, higher yields and rising funding costs would represent a challenging combination for cyclically sensitive metals. Instead, persistent supply-side turbulence continues to offset concerns about demand and tighter financial conditions.

Zinc has become the latest example, rising towards USD 4,000 per tonne on the LME and reaching its highest level since May 2022. Falling refined inventories outside China, constrained raw-material availability and tight positioning have supported the rally.

Copper has also remained resilient after recently reaching record levels, with LME copper holding above USD 14,000 per tonne. Tight nearby availability and large volumes being pulled towards the US continue to support prices, while backwardation in both copper and zinc signals physical tightness.

Supply challenges were highlighted by the latest production update from Chile, where statistics agency INE said output in the world's largest copper-producing country fell 9.4% year-on-year in July after severe storms struck mining regions. The divergence between precious and industrial metals underlines that the current commodity rally is not simply a monetary phenomenon. Where physical availability is sufficiently tight, supply constraints continue to override macroeconomic headwinds.

The coming weeks may determine which of these forces dominates. Further strength in oil, refined products and food could keep inflation expectations elevated and reinforce expectations for additional monetary tightening. That would remain a near-term headwind for gold and silver while potentially weighing on broader risk appetite and commodity demand.

At the same time, higher policy rates and rising long-term yields increase borrowing costs across economies already carrying historically large debt burdens. The longer rates stay elevated, the greater the fiscal strain and the stronger the potential focus on debt sustainability, currency debasement and eventual policy intervention.

Commodities are therefore caught between rising rates and rising inflation, but the pressures are far from uniform. Energy and agriculture continue to benefit from scarcity and geopolitical disruption, industrial metals remain supported by tight supply, while gold and silver are temporarily paying the price for tighter monetary conditions and a stronger dollar.

The paradox is that if rising commodity prices force interest rates higher for longer, the resulting pressure on heavily indebted governments could eventually revive the fiscal and debasement concerns that have been among the strongest structural drivers of investment demand for precious metals.

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