

Yellow metal is flying high

Gold continues to soar. In the meantime, some of the other metals continue to languish as global consumption declines further. An **MF Global** report.

Will the recession in the world's dominant consumer of natural resources, the US, be U-shaped or L-shaped? This question is being strongly debated by economists across the globe. When it comes to the stimulus packages in the US, there are concerns about how much is enough, as well as uncertainty about how these gigantic packages will be implemented and how they will be beneficial.

There are concerns about the EU, too. Western European banks could suffer because of their inordinately large exposure (at US\$1.4 trillion) to Eastern European banks. Eastern Europe has witnessed a sharp slump in growth, as well as a rise in defaults. There are fears that these defaults will only rise, plunging Western European banks into deep losses.

The US, the EU and Japan, as well as many of the emerging economies, have slipped into a recession. This circumstance means more pain for commodities (base metals and energy). On the other hand, the rising uncertainty has heightened the need for capital protection and has left investors with a very low risk appetite, brightening the outlook on precious metals.

In the precious metals complex, gold has soared and is nearing the US\$1000 per ounce mark. Gold has defied its traditional inverse relationship with the US dollar, and there have not been significant developments on the geopolitical map for us to flock to gold. It's been said that gold's allure has increased because of a heightened global economic risk (read meltdown). According to recently released World Gold Council statistics, identifiable investment demand (through gold bar hoarding) increased slightly in the fourth quarter of 2008 at 399 tonnes, but was up 192 per cent from the same period in 2007.

Near-month gold futures have gained 16 per cent on month to US\$978 per tonne. Silver, which had been struggling from its

'industrial metal tag' earlier, has seen an even sharper jump, with near-month futures gaining 27 per cent to US\$14.24 per ounce.

In the base metals complex, gloom continues. Copper (LME three-month forwards) has slid three per cent on month to US\$3255 per tonne. In the same period, aluminium is down eight per cent to US\$1338 per tonne, nickel is down nine per cent to US\$9850 per tonne, zinc is down 10 per cent to US\$1120 per tonne and lead metal is down nine per cent to US\$1067 per tonne. A sharp drop in global car sales and construction activity continues to plague the base metals.

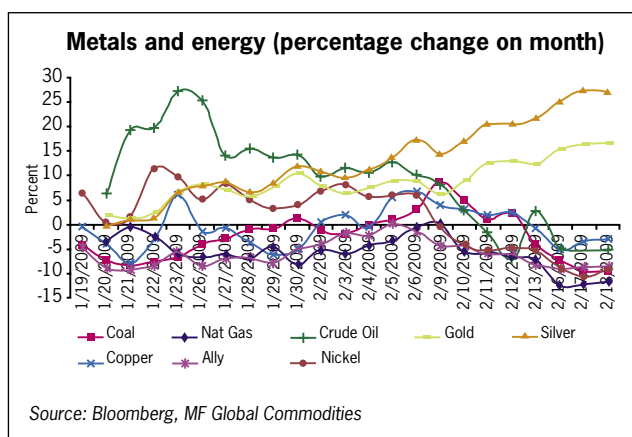
Meanwhile, the global mining giants that were planning aggressive mergers and acquisitions in the early half of 2008, when base metals touched new highs, are now burdened by huge debts. In an effort to buy each other at very high valuations and on the subsequent slump in base metal prices, mines have been saddled with billions of dollars in debt. Such is their plight that they have been forced to sell some of their family silver in the form of stakes of their various mines to service their debts.

In the energy space, natural gas futures have seen the sharpest decline on month. Near-month natural gas futures have dropped 11 per cent on month to US\$4.24 per mMBtu [million British thermal units] and have corrected nearly 70 per cent from their high of around US\$13 per mMBtu.

A sharp slump in demand due to stalling industrial production in the US, Europe and Northeast Asia (Japan and South Korea), along with higher supplies, has pressured natural gas. According to the US Energy Information Administration, gas inventories in the country are now nearly one per cent above the five-year average at 2.020 trillion cubic feet and two per cent higher over last year.

Coal (ICE near-month futures) has seen the second largest decline in the energy complex, dropping nearly 10 per cent to US\$68.50 per tonne. Increasingly, coal miners are under pressure from steel companies to renegotiate contracts at lower prices. Some steel companies have demanded a 50 per cent cut in contract prices. On the brighter side, coal miners could see a window of opportunity in the form of improved exports if the month-long standoff between Chinese coal miners and power companies drags on. Chinese monthly imports, after falling sharply last November to 2.16 million tonnes from 3.48 million tonnes, have been increasing marginally. January 2009 imports stood at 2.88 million tonnes, compared to the previous month's 2.67 million tonnes in the world's largest coal consumer.

Moving ahead, the base metals and energy complex is expected to remain under pressure as global consumption declines further. The focus will be on how the Eastern European banking situation unfolds and its resultant impact on consumption in the EU.



The information in this column is provided by MF Global. For further details, write to: contactdubai@mfglobal.ae or call +971 4 332 5052. Source: MF Global Commodities India Pvt Ltd, Bloomberg.