

Commodities under pressure

The surge in the US dollar and the tightening of the hike in Chinese rates put commodities under pressure. An **MF Global** report.

Commodities have been under pressure for the past month, impacted by the US dollar's surge. US president Barack Obama's plans to curtail the risk-taking abilities of banks and China's bank rate hikes also weighed on asset prices.

The US dollar was the most favoured currency apart from the Japanese yen, as risk fears plagued markets with increased worries over Greece's debt problems. With many of the members in the Eurozone struggling with heavy government spending and the growth rate beginning to show the first signs of a strain in leading economies like Germany and France, risk aversion bets have become the centre of focus. The US dollar has benefited over the euro.

With a US dollar rally, commodities across the board have been hit on concerns of weakening demand due to higher dollar costs.

Precious metals – gold in particular – continued to trade inverse to the dollar's move and fell to US\$1094 per ounce, down three per cent on month (COMEX near-month futures). Silver ended weaker on month not just following gold, but also because of a strong fall in base metals, falling 14 per cent to US\$15.42 per ounce.

Data from India, the world's largest importer of gold, shows that consumers have stepped up physical buying due to falling prices. India's gold imports in January are estimated to have jumped to 35-40 tonnes from 9.80 tonnes the previous month.

Commodities were also hit by President Obama's announcement that he planned to prevent banks from running hedge funds or proprietary trading accounts in search of higher returns. This statement increased concerns about forceful liquidation of commodity positions by these entities.

The two rounds of rate tightening by China also affected the market. While the first interest rate hike was anticipated, the second hike within a month in February came as a surprise and raised alarms that China was looking to curb its runaway growth rate and aim for lower but more sustainable growth. This, of course, raised concerns over the consumption of base metals in the short term. China's profound positive impact on base metals need not be retold.

Glum outlook

Base metals' bellwether copper fell by eight per cent to US\$6810 per tonne (LME three-month forwards). Despite concerns over demand drop, tightness has been felt in the copper market in China, with Shanghai quoting at a premium of over 1200 yuan per tonne to LME that could prompt higher imports. China's copper imports were also higher in January, up by 25 per cent to 292,096 tonnes.

Aluminum corrected nine per cent to US\$2055 per tonne over the month, despite higher auto sales reported from car majors like GM and Ford and from China and India. There are concerns that the pace of auto sales may not sustain as Asian countries withdraw stimulus measures, as is expected in India and China.

Worries over Europe and the US are likely to continue for a while, keeping the demand outlook glum. The supply overhang also weighs on prices. Rusal, a major player, is likely to re-commission 100,000 tonnes, leaving out 500k as mothballed capacity.

In the energy sector, coal prices were down sharply on a slowdown in demand from Europe. Weaker buying interest from India also impacted prices, as did worries that Chinese imports would slow down

going into the weeklong Lunar New Year holidays. Coal ended at US\$73.40 per tonne, down by 16 per cent on month (ICE near-month futures). Crude oil dropped eight per cent to US\$74.18 per barrel, weighed down by a strong dollar and concerns over stagnant demand in the US, which saw demand at 18.75 million barrels per day in January, down two per cent from December and four per cent on year.

A spate of storms dumped massive amounts of snow across the east coast and mid-Atlantic regions in the US. This was said to have impacted road transport negatively and in turn gasoline consumption. Consumption fell by 4.20 per cent in January month on month.

The past month or so has also seen major agencies differing on oil demand estimates, with OPEC and the US Energy Administration estimating demand at 85 million barrels per day, while the International Energy Administration (IEA) estimated 86.50 million barrels per day. According to the IEA, compliance among OPEC members fell to 58 per cent of allocated quota in January from 61 per cent in the prior month, with the market thus ending up with an excess supply of 1.80 million barrels per day.

Going forward, the outcome on Europe's planned rescue of Greece will be closely followed, and any ambiguity in the package will lead to further dollar strengthening. Concerns remain over the sustainability of growth rates, as governments look to withdraw stimulus measures. A major worry so far has been the rather poor transmission of a manufacturing-led rebound into the services sector. This is likely to weigh on growth rates in major economies where the services sector is a dominant employment contributor.