

Commodities look uncertain

The commodities market reflects the uncertainty in equities as doubts begin to emerge over economic recovery. An **MF Global** report.

Base metals were under pressure last month on concerns over a seasonal slowdown from China, which seems like the only source of strong demand. Crude oil also showed weakness due to regulatory worries over trading limits on futures.

Crude oil (NYMEX near-month futures contract) was down 14 per cent on month to US\$61.70 per barrel. Global demand, including that from the US, remains weak. Crude was also weighed down by talks of increased regulation. The US Commodity Futures Trading Commission (CFTC) has decided to gather views from market participants on setting new limits on energy futures contracts. It will hold a series of hearings in July and August to decide how it can best use its authority to prevent speculation following complaints from Congress and market traders.

The CFTC decides the limits on agricultural commodities, but in the case of energy futures contracts, the decision rests with individual exchanges.

Another interesting development in the crude oil futures market was the reduction in the normally positive difference between WTI and Brent varieties of crude oil to zero and negative thereafter. Some attribute this change to a tighter supply on the European side due to maintenance work on oilrigs in the North Sea and a string of attacks on oil pipelines in Nigeria. Another reason being attributed is the possibility of a limit on WTI crude oil futures by the CFTC.

The natural gas near-month futures contract was down 15 per cent on month to US\$3.27 mmBTU. Forecasts for milder weather across key consuming areas in the US, which includes the Midwest, the mid-Atlantic

and the southeast region, have raised concerns over declining consumption. US natural gas reserves are trending over the five-year average, thus building up steady pressure.

On the European side, Romania, Bulgaria, Hungary and Austria signed an agreement with Turkey to construct the 3300-kilometer 'Nabucco' gas line. Iran, Iraq, Kazakhstan, Turkmenistan and Egypt are considered potential suppliers to the Nabucco project. This deal assumes importance for Europe, which has been trying to reduce its dependence on Russia. Russia supplies nearly 30 per cent of Europe's gas requirements.

Concerns

Gold (Comex near-month contract) remained mostly under pressure, tracking the higher trending US dollar and the decline in crude oil. Gold was down 0.19 per cent on month to US\$939 per ounce after dropping to US\$912 during the month. However, an increase in duty in India is unlikely to have any demand impact on gold and is expected to be easily absorbed.

Silver (Comex near-month contract) was down 11 per cent to US\$13.20 per ounce and continued to remain under pressure tracking the weakness in gold as well as base metals. Base metals continued to remain under pressure through the month on concerns of a seasonal drop in China's demand. In the past few months, China's purchases have overwhelmingly supported the uptrend in base metals.

Bellwether copper continued to remain choppy through the month and gained about 0.5 per cent on month to US\$5260 per tonne (LME three-month forward contract). Copper stocks on the LME have shown a continuous slide,

albeit not a very strong one. Although China's June imports touched another record, copper remained rather choppy over concerns that China's state reserves bureau would stop buying copper in the third quarter.

Aluminum continues to stagger under a massive buildup of stocks at the LME. Reports of a planned strike in Venezuela, a planned 50 per cent reduction in output by Rusal at its Guinea alumina plant or an increase in production by Japanese companies following improved demand from beverage and car manufacturers there did not help. Aluminum nudged higher on month to US\$1655 per tonne, up by 0.6 per cent.

Tin saw a sharp correction of 15 per cent on month to US\$13,300 per tonne. Many heaved a sigh of relief, as prices had risen sharply over past two months. In reality, though, global demand remained weak and the LME inventories continued to climb to new 52-week highs.

On the whole, base metals have remained in surplus through the first half of 2009. The World Bureau of Metals Statistics reported that during January to May, copper was in surplus of 90,000 tonnes, nickel was in surplus of 86,100 tonnes, tin was in surplus of 4700 tonnes, lead was in surplus of 6000 tonnes and zinc was in surplus of 49,800 tonnes.

Going forward, the movement in base metals will be under the scanner on concerns of a steeper correction. Chinese demand remains questionable in the short term. Demand from European and North American economies is also seen as insipid, as the slump in housing and the auto industry is likely to last longer, with unemployment climbing.



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