

# Commodities are looking up

Economic data showing that growth deceleration is slowing down and possibly reversing has encouraged improved inflows in commodities. An **MF Global** report.

**C**rude oil and base metals, in particular, have seen blistering gains over the past month. A string of economic data from major economies like the EU, Japan and the US shows that the growth deceleration is either reversing or slowing down sharply. This has prompted improved inflows in commodities on hopes of increased re-stocking demand.

In the base metals space, nickel (three-month LME forward contract) has gained the most by nearly 32 per cent to US\$19,575 per tonne. Stainless steel demand is expected to improve not just in China, but also in other regions, primarily driven by auto sector growth. There has also been a series of mine closures at Vale Inco in Canada due to either strikes or maintenance-related shutdowns, which remained supportive for nickel.

After nickel, copper and aluminum were the second best performers in the group, each rising by 27 per cent to US\$6245 and US\$1990 respectively.

In the case of copper, China's buying showed some signs of restraint as imports dropped 15 per cent on month to 406,612 tonnes. But this data was ignored and instead the focus was on the import of scrap copper, which rose by 61 per cent to 450,000 tonnes in the same period. In the case of aluminum, prices have been in an uptrend despite LME stocks near record highs. There have been reports that some 1.5 million tonnes of the current 4.55 million tonnes of stocks at LME have been tied in financial deals. As a result, these will not be delivered. Market players are hoping that an improvement in automobile sales in the US and Europe, apart from China and India, will help improve demand for aluminum.

Automobile sales have seen some signs of life following various stimuli offered by countries in the Eurozone and the US. In Europe, new car registrations increased by

2.4 per cent in June to 1.4 million units, according to data released in July by its automobile manufacturers association.

In the US, the one-billion-dollar "cash for clunkers" programme has been termed as a success and Congress has increased the size by another two billion dollars. This programme is aimed at improving new car sales by offering an incentive of up to US\$4500 to owners of old cars and trucks if they shift to new, more efficient vehicles. The positive effect of the programme has been evident from increased auto sales in July. Sales touched 11.4 million units for the first time since 2009. In China and India, various incentives like cuts in retail taxes, subsidies and loans offered at lower interest rates have led to improved demand.

Zinc has risen by 26 per cent to US\$1825 on hopes of improved demand for galvanised steel, while lead has gained 19 per cent to US\$1852, as demand for car batteries is expected to rise following improvement in auto sales in China.

Crude oil (NYMEX near-month futures) has gained over 12 per cent to US\$66.94 per barrel. Presently, crude oil continues to mirror the progress of US equity indices. Record imports from China and improved imports from India at the start of the monsoon season have also helped sentiments.

But demand from the world's largest consumer, the US, is likely to remain under pressure. The success of the "cash for clunkers" programme, which advocates the use of new energy efficient cars, is unlikely to have a positive impact on demand for crude.

Global energy agencies are forecasting an improvement in demand in 2010, but they remain divided over the prospect of the remainder of 2009.

OPEC, which controls around 40 per cent of global supply, continues to hold

the view that the daily global demand in 2009 will be at 83.91 million barrels per day, down by 1.65 million barrels per day, even though economies around the globe are showing signs of revival. Also, the US Energy Information Administration (EIA) has forecast a drop in global oil consumption by 1.71 million barrels per day to a revised 83.76 million barrels per day in 2009. To be fair, the Paris-based International Energy Association (IEA) raised its 2010 demand forecast by 70 kb/d, but changes to IEA data have been more frequent and larger in size, making them somewhat less informative than the EIA numbers

In the precious metals complex, gold has nudged higher by two per cent to US\$947 per ounce (COMEX near-month futures) tracking the US dollar's weakness against the euro. However, with the euro increasingly struggling to maintain upward momentum against the US dollar, gold bulls remain cautious. In other developments, a new central bank gold agreement has been signed, which will come into force after the existing five-year agreement expires this September. Nineteen central bank signatories to this agreement have agreed to sell not more than 400 tonnes per year (100 tonnes lower from the last agreement) up to 2014.

Silver, also considered an industrial metal, has gained over 12 per cent to US\$14.42 per ounce, supported by the steep surge in the base metals complex and less so by gold.

Going forward, commodity bulls are hoping that the market loses its overwhelmingly high correlation to China when it comes to demand. Hopes run high that positive GDP growth in economies like Germany, France and Japan during the second quarter spreads and becomes a global trend.



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