FICC Research

Commodities: Daily

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Focus: A weaker RMB spurs commodity demand

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- Base metals have rallied strongly following announcements over the possible revaluation of the Chinese RMB.
- With gold above $1,250, we believe the path is now set for the metal to test $1,280.
- As with the metals, crude oil is finding good support. Our view on crude oil remains unchanged, and we believe that it will trade above $80 towards end June.

Commodity price data (18 June 2010)

Base metals LME 3-month	Open	Close	High	Low	Daily change	Change (%)	Cash Settle	Change in cash settle	Cash – 3m
Aluminium	1,956	1,944	1,972	1,933	-12	-0.61%	1,931.00	-20	-30.82
Copper	6,340	6,440	6,485	6,310	100	1.58%	6,315.50	-165	-27.10
Lead	1,730	1,745	1,765	1,716	15	0.87%	1,706.50	-9	-22.93
Nickel	19,375	19,590	19,800	19,250	215	1.11%	19,305.00	-380	-72.00
Tin	17,455	17,455	2,019	17,451	0	0.00%	17,450.00	150	-61.00
Zinc	1,735	1,730	1,770	1,722	-5	-0.29%	1,703.50	-24	-33.00

Energy	Open	Close	High	Low	day/day	Change (%)
ICE Brent	78.49	79.50	79.57	78.49	1.28	1.61%
NYMEX WTI	77.50	78.65	78.69	77.33	1.47	1.87%
ICE Gasoil	683.00	690.25	690.25	683.00	9.25	1.34%
API2 Q3'10	96.10	94.50	-	-	-1.60	-1.69%
EUA Dec10	15.62	15.70	-	-	0.08	0.51%

Precious metals	AM Fix	PM Fix	High bid	Low offer	Closing bid	Change (d/d)	EFPs
Gold	1,244.00	1,256.00	1,262.20	1,242.00	1,256.50	9.50	1.0/1.4
Silver	-	19.32	19.26	18.72	19.17	0.41	-2.0/0.0
Platinum	1,571.00	1,578.00	1,587.00	1,574.00	1,585.00	15.00	-1.0/1.0
Palladium	478.00	484.00	493.00	482.00	491.00	12.00	-0.5/1.5

Sources: Standard Bank; LME; BBG

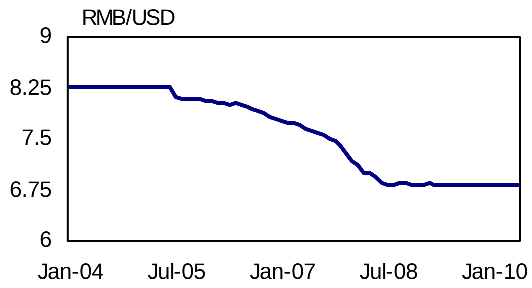
Focus: A weaker RMB spurs commodity demand

This weekend, the PBOC announced more reforms to China's exchange rate regime. While the market has been talking about a possible revaluation of the renminbi (RMB) for some time, there has been little action from China so far. Point estimates of the RMB's current undervaluation ranges from zero to 30%. The impact on commodities is unlikely to be straightforward, and should depend on how China goes about revaluing the RMB. However, we see three scenarios:

1) China reinstates the crawling peg system, as before the financial crisis. If this happens, the initial impact should be limited, as currency moves should also be very limited. However, a crawling peg system where the RMB appreciates slowly over time may actually see more money flowing into China, as the market anticipates currency appreciation. More money into China could see their foreign reserves build even more, amplifying global liquidity that is concentrated in China's global reserves. This should favour the longer-term prospects of gold (but also most other commodities in general), given gold's close relationship with global liquidity and the continued accumulation of liquidity. It would also make RMB-denominated commodity prices cheaper than what it would have been if the RMB was pegged against the dollar. At the margin, it could benefit commodity demand from China.

2) China makes a one-off, large revaluation, of say 15% to the RMB. The immediate impact could see a rise in demand for commodities from China — simply because all dollar-denominated commodities would suddenly be 15% cheaper for China. This should favour commodities with large exposure to China, e.g. copper. However, a significantly stronger currency means tighter monetary conditions and over a couple of months a stronger currency may start weighing on China's trade balance. China is likely to import more final goods and export less. With a smaller trade balance (or even a negative one) there could be lower GDP growth and less demand for commodities. This may be the case in particular if spending emphasis shifts from government's capital expenditure to consumer final consumption expenditure.

RMB/USD exchange rate



Sources: BBG; Standard Bank

3) China goes for a full-blown floating currency. Should this happen, and say the RMB is currently undervalued by 20% the initial effect may be similar to Scenario 2. The difference would be that China's growth in reserves may end suddenly. A stronger currency should see a knock-on effect on the Chinese trade balance. Their foreign reserves will not disappear but the massive rise in reserves every month could slow substantially if the currency appreciates by a great margin. Furthermore, their dollar denominated foreign reserves becomes less in RMB which could even slow government spending. After a few quarters, demand for commodities from China may slow as growth tapers down.

We believe Scenario 1 should be China's preferred option.

By Walter de Wet

Base metals

Base metals have rallied strongly following announcements over the possible revaluation of the Chinese RMB.

In Shanghai, copper hit the 5% upper limit this morning before closing slightly lower. The Shanghai/LME arbitrage window remains closed, which is discouraging any follow-through buying in China. The price ratio stood at 7.93 on Friday and closed at 8.02 today. While the ratio is moving in the right direction, a ratio closer to 8.15 is needed to spur copper buying interest on the LME from China. Apart from the announcement regarding the RMB revaluation, a fatal explosion at a Khazakhmys plc mine in Kazakhstan seem to have added support to copper. Copper is providing support to the rest of the complex.

Overall, the correlation between base metals and especially US equity markets remains high. The S&P and Dow are now well above their 200d MA and looking at the US futures market the gap could widen further today. This could add support to base metals.

On a relative basis, we believe that zinc is undervalued. We believe zinc is mispriced relative to other base metals, equity markets, risk (as proxied by the VIX) and even crude oil. Put differently, should base metals see further liquidation, zinc may found support at higher levels than the rest of the complex. In the physical market, there is no sign of tightness in the zinc market. Premiums remain generally soft, and LME and Shanghai inventory levels continue to rise. But with zinc approaching $1,700, margins at Chinese smelters are under pressure, and they are refusing to sell metal. A more sustained price drop would likely see capacity start to shut again. Combined with the relative mispricing between zinc and other markets, combined with our view that the zinc market will tighten up in 2011, zinc below $1,700, may provide value.

By Walter de Wet

Precious metals

With gold above $1,250, we believe the path is now set for the metal to test $1,280. However, as before, whenever the metal reaches new highs, we might see some profit-taking and producer selling. We would expect a pullback to be less severe than the previous pullback when gold dropped from $1,250 to $1,170.

The futures market remains well placed to support a higher gold price. COMEX gold has seen the net long non-commercial position has declined to 33.47% of OI, down from 34.1% the previous week. Current levels are below the average level of 36% over the past 12 months.

Gold support is at $1,244 and $1,233, resistance at $1,265 and $1,274.

Platinum and palladium are finding very good support. Palladium is back at $500, platinum is trading above $1,600. Our target remains $1,800 and $650 for platinum and palladium respectively. We still believe that palladium will continue to outperform platinum during the course of the year. However, more short-term platinum may outperform palladium. Platinum saw a spectacular decline in net longs in May, with the non-commercial long position declining from 64% of open interest (OI) in mid-May to 51% of OI last week. In sharp contrast, palladium's net non-commercial long position has remained fairly constant around 60% of OI. Comparing the futures market of platinum and palladium, platinum could see additional longs in coming weeks. Should platinum break above $1,620, we would look for more upside.

By Walter de Wet

Energy

As with the metals, crude oil is finding good support. Our view on crude oil remains unchanged, and we believe that it will trade above $80 towards end June.

NYMEX WTI has seen the net long non-commercial position increased from 3.7% of OI to 4.17%. This is marginally higher than the 3.65% reached two weeks ago but well in line with levels observed the past 12 months. We believe it signals more length to be added.

This weekend, the PBOC announced more reforms to China's exchange rate regime. Point estimates of the RMB's current undervaluation ranges from zero to 30%. The impact on crude oil is unlikely to be straightforward and should depend on how China goes about revaluing the RMB. The most likely outcome remains China reinstating the crawling peg of their currency as before the financial crises. If this happens, the initial impact should be limited, as currency moves should also be very limited. But a crawling peg system where the RMB appreciates slowly should make all dollar-priced commodities cheaper for China. Given the negative price elasticity between price and demand, a lower domestic oil price in China relative to where it would have been if the RMB remained pegged against the dollar, could see demand for energy from China rise. We view any appreciation in the RMB as bulish for oil as well as thermal coal.

There are very few data releases out today to drive the crude oil market. However, the correlation between crude oil front-month prices and US equities remains high. The S&P and Dow are now well above their 200d MA and, looking at the US futures market, the gap could widen further today. This could add support to base metals.

By Walter de Wet

Base metals

Daily LME stock movement (mt)									
Metal	Today	Yesterday	In	Out	One day change	YTD change (mt)	Cancelled warrants (mt)	Cancelled warrants (%)	Contract turnover
Aluminium	4,467,350	4,474,175	-	6,825	-6,825	-161,550	326,925	7.32	224,708
Copper	456,950	457,425	1,600	2,075	-475	-45,375	29,475	6.45	117,500
Lead	189,425	189,800	200	575	-375	42,925	16,850	8.90	20,320
Nickel	128,784	129,798	-	1,014	-1,014	-29,226	7,200	5.59	22,858
Tin	20,000	20,305	-	305	-305	-6,765	2,340	11.70	7,728
Zinc	617,925	618,025	-	100	-100	129,875	17,175	2.78	49,883

Shanghai 3-month forward prices				COMEX active month future prices				
Metal	Open	Last	1d Change		Open	Close	Change	Change (%)
Aluminium	14,650	14,740	190	Ali May'10	-	-	-	-
Copper	51,590	52,500	1,140	Cu May'10	290	300.50	10.35	3.57%
Zinc	14,245	14,750	610					

ZAR metal prices (18 June 2010)							
	Aluminium	Copper	Lead	Nickel	Tin	Zinc	ZAR/USD fix
Cash	14,569	47,650	12,876	145,656	131,660	12,853	7.5450
3-month	14,889	49,323	13,365	150,036	133,684	13,250	7.6588

Energy

Energy futures pricing	Price	Change	Price	Change	Price	Change	Price	Change	Price	Change
	1-month forward		2-month forward		3-month forward		6-month forward		1-year forward	
Sing Gasoil ($/bbbl)	86.19	-0.17	89.64	-0.71	90.11	-0.64	91.36	-0.45	-	-
Gasoil 0.1% Rdam ($/mt)	690.25	9.25	691.50	9.25	691.25	6.50	702.25	9.00		
NWE CIF jet ($/mt)	710.43	-1.28	733.35	-3.24	737.34	-2.50	750.66	-2.09		
Singapore Kero ($/bbl)	87.20	-0.18	90.59	-0.66	91.26	-0.54	92.96	-0.30		
3.5% Rdam barges ($/mt)	417.33	-3.55	427.25	0.00	430.75	0.25	440.75	0.50		
1% Fuel Oil FOB ($/mt)	438.48	-4.02	456.50	0.75	462.00	1.00	475.75	1.00		
Sing FO 380 Cargo ($/mt)	449.75	-0.75	452.50	-0.25	452.50	-0.25	452.50	-0.25		
Sing FO180 Cargo ($/mt)	440.61	-2.61	454.75	0.00	458.75	0.00	468.75	0.00		
Thermal coal	Q3-10		Q4-10		Q1-11		Cal 11		Cal 12	
API2 (CIF ARA)	94.50	-1.60	96.90	-1.10	99.00	-0.80	101.25	-0.75	107.85	-0.75
API4 (FOB RBCT)	92.75	-0.85	93.90	-1.10	96.00	-0.55	97.90	-0.60	101.25	-0.75

Precious metals

Forwards (%)	1-month	2-month	3-month	6-month	12-month		
Gold	0.51600	0.54800	0.56800	0.68400	0.80400		
Silver	0.64000	0.66000	0.70000	0.78000	0.83000		
USD Libor	0.34734	0.43250	0.53819	0.75063	1.18313		
Technical Indicators	**30-day RSI**	**10-day MA**	**20-day MA**	**100-day MA**	**200-day MA**	**Support**	**Resistance**
Gold	61.99	1,235.90	1,226.71	1,155.88	1,124.36	1,244.00	1,274.00
Silver	57.99	18.54	18.36	17.56	17.53	19.00	16.50
Platinum	50.78	1,560.79	1,549.55	1,609.68	1,516.08	1,500.00	1,550.00
Palladium	53.78	466.78	458.32	476.49	419.43	485.00	510.00
Active Month Future	**COMEX GLD Jun'10**	**COMEX SLV Jul'10**	**NYMEX PAL Jun'10**	**NYMEX PLAT Jul'10**	**DGCX GLD Jun'10**	**TOCOM GLD Feb'11**	**CBOT GLD Jun'10**
Settlement	1,245.70	18.7500	479.25	1,572.00	1,245.80	3,641.00	1,245.50
Open Interest	569,744	132,031	21,636	30,832	1,502	108,516	2,776
Change in Open Interest	-4,000	-3,151	-232	-370	-182	3,041	28

Date: 18 June 2010

Sources: Standard Bank; LME; Bloomberg

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