

# FICC Research

## Commodities: Daily

Focus: We see demand for houses and hence metal



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Walter de Wet, CFA\*  
Walter.DeWet@standardbank.com

Leon Westgate\*  
Leon.Westgate@standardbank.com

**Focus:** From a metal demand perspective, we look at Chinese housing market from a different angle than the US housing market. Prices fall for two reasons: either demand must decline, or supply must rise. Total demand for housing in China's cities is likely to remain healthy. If demand so, supply must rise. New houses require new metal, therefore, we do not expect metal demand from construction to slow dramatically.

- A stronger Shanghai Composite equity market and a weaker dollar have seen the base metals rally strongly during the morning session. Volumes have also picked up from Monday's levels but still remain relatively subdued.
- It is clear to us that concerns over Europe's sovereign debt burden will remain at the forefront for the rest of the year. At the same time, interest rates are set to remain low. We therefore believe that investment demand for gold will remain strong. We still target \$1,300 for gold in Q4:10.
- WTI is tracking the dollar ahead of the return of the US markets, with a weaker dollar seeing front month WTI trade back above \$73/bbl.

### Commodity price data (5 July 2010)

#### Base metals LME 3-month

	Open	Close	High	Low	Daily change	Change (%)	Cash Settle	Change in cash settle	Cash – 3m
Aluminium	1,934	1,965	1,957	1,931	31	1.60%	1,912.00	-21	-27.25
Copper	6,470	6,470	6,568	6,450	0	0.00%	6,440.00	10	-27.75
Lead	1,760	1,765	1,780	1,753	5	0.28%	1,731.50	-5	-24.75
Nickel	18,725	19,000	19,239	18,650	275	1.47%	18,775.00	-340	-67.00
Tin	17,050	17,475	6,581	17,050	425	2.49%	17,250.00	-50	-35.20
Zinc	1,840	1,840	1,841	1,795	0	0.00%	1,765.00	-5	-32.25

#### Energy

	Open	Close	High	Low	day/day	Change (%)
ICE Brent	71.47	71.51	71.54	70.77	0.04	0.06%
NYMEX WTI	72.06	72.00	72.70	71.09	-0.14	-0.19%
ICE Gasoil	610.00	612.00	612.00	607.00	4.00	0.65%
API2 Q3'10	94.00	93.75	-	-	-0.25	-0.27%
EUA Dec10	15.32	15.33	-	-	0.01	0.07%

#### Precious metals

	AM Fix	PM Fix	High bid	Low offer	Closing bid	Change (d/d)	EFPs
Gold	1,208.50	1,208.00	1,214.50	1,201.80	1,206.50	0.00	0.3/0.7
Silver	-	17.83	17.91	17.65	17.70	0.00	0.5/2.5
Platinum	1,511.00	1,506.00	1,515.00	1,501.00	1,497.00	0.00	-1.0/1.0
Palladium	433.00	429.00	435.00	427.00	425.00	0.00	-0.5/1.5

Sources: Standard Bank; LME; BBG

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## Focus: We see demand for houses and hence metal

There is great deal of concern over the current housing market in China and what it means for metal demand. In May 2010, the average house price in 70 cities in China rose 12.4% y/y, slightly less than April's 12.8% rise. New house prices increased at 15.1% y/y while existing house prices were up 9.2% y/y in May. Although the increase in house prices seems very high, much of it is due to base effects. Between Dec 2008 and May 2009, y/y house price growth was in negative territory.

At the same time we estimate that average earnings in China have been rising by almost 15% p.a. since 2005, almost twice the average rate of 5.9% y/y for house prices. This is a positive sign.

However, we have two major concerns. *Firstly*, while income growth in China (average of 15% p.a.) has exceeded the rise in house prices (5.9% p.a.), income growth is skewed towards higher income earners (similar to many other parts of the world). *Secondly*, even if income growth was not skewed, new house prices are now rising as fast as the average earnings in urban areas. This is not sustainable in the long term.

China's Gini-coefficient, which measures income inequality, is 0.47. A Gini-coefficient of 0 implies complete income equality, while a coefficient of 1 implies complete inequality. To put China's income distribution in perspective: most European countries have a Gini-coefficient of less than 0.30, which implies a fairly equal income distribution. The US has a coefficient of 45, while Brazil has one of the most skewed income distribution with a coefficient of 0.57.

For China wages are rising from an average income perspective. But the income gap is large and the median income (as opposed to average income) is unlikely to have grown at 15% p.a. (due to skewed income distribution), making current rise in house price increases unaffordable for many low- and middle-income earners.

## Base metals

A stronger Shanghai Composite equity market and a weaker dollar have seen the base metals rally strongly during the morning session. Volumes have also picked up from Monday's levels but still remain relatively subdued. Prices are coming off the boil a little ahead of the return of the US markets, with US equities likely to dictate direction this afternoon.

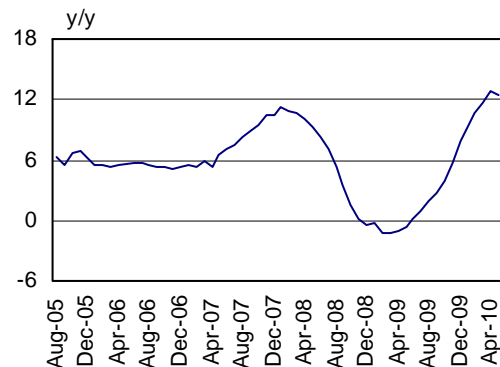
Its rather quiet data-wise, with the market still very much focused on Thursday's ECB rate announcement and accompanying statement. With little else for the market to get its teeth into, trading will likely remain choppy in the interim.

Copper saw light arbitrage buying emerge during Asian trade, helping prices climb above \$6,500, while a weaker dollar has seen the red metal trade back above \$6,550 heading into the afternoon. Momentum has faded ahead of the return of the US markets after their long weekend however, with the market in wait and see mode.

LME inventories have continued to come under pressure, with on-warrant copper stocks falling by 3,700 mt. Asia continues to be the focus for the activity, with Busan accounting for the majority of today's decline. Falling LME stocks (on-warrant stocks down 2% since the start of July and down 18% since the beginning of April), coupled with signs of increased demand from China are lending support to prices, in spite of the ongoing concerns over Europe and the recent lacklustre economic data.

In the background, rumours and subsequent denials over the settlement of the mid-year copper TC/RC contracts are swirling around. With the concentrates market remaining very tight, consensus estimates are for a mid-year deal around the \$40/mt and 4¢/lb level. This is significantly lower than the \$46.5/4.65¢ annual 2010 deal, but above the miner's opening stance of \$35/3.5¢

## China house prices



Source: NDRC

We therefore believe that the price rise is unsustainable.

From a metal demand perspective, we look at Chinese housing market from a different angle than the US housing market. Prices fall for two reasons: either demand must decline, or supply must rise. Short-term demand may slow due to government measures to cool property speculation in China. But unlike many developed markets, urbanisation continues rapidly in China. Therefore, total demand for housing in China's cities will remain healthy — especially lower income housing. If demand grows, then supply must rise (especially lower income houses). This is bullish for metal demand.

We acknowledge for existing home owners (likely to be high income earners), there could be a negative wealth effect if house prices fall. In our view, this would affect final consumption expenditure more than primary metal demand.

By Walter de Wet

By Leon Westgate

## Precious metals

Following gold's on Thursday last week, good physical demand has been supporting the price. At the same time, ETF holdings remain largely unchanged. In fact, as of yesterday, the latest figures show that ETF holdings are marginally higher, having added 134,189oz since last week.

We continue to focus on Europe's debt burden. During Q2:10, the roll-over of government debt by Greece and Spain were cause of great concern to markets. We now look to Italy which is starting to roll sizable amounts of debt in August. Between August and November, Italy must roll around Eur134bn. This dwarfs anything Spain and Greece had to roll, even after accounting for size of GDP. Furthermore, Italy's debt stock is at 115% of GDP, much higher than that of either Spain or Greece.

In terms of FX, Standard Bank sees the euro at \$1.15 at the end of this quarter. Thereafter, we see even more downside to the euro. As always, the impact of FX moves on commodity prices depends on the speed of depreciation/appreciation.

It is clear to us that concerns over Europe's sovereign debt burden will remain at the forefront for the rest of the year. At the same time, interest rates are set to remain low. We therefore believe that investment demand for gold will remain strong. We still target \$1,300 for gold in Q4:10. Combined with our view on the euro, we expect gold in euros to outperform gold in dollars. Our only concern to this view is potential money market problems in Europe. Three-month Euribor continues to rise (it closed at 0.79% yesterday). A breakdown of money markets would be detrimental — even to gold.

Gold support is at \$1,205 and \$1,201, resistance at \$1,213 and \$1,218.

Platinum and palladium remain range-bound. Our view on the metals are unchanged. We see value below \$1,500 and \$420 for platinum and palladium respectively. We would not be surprised if both metals push a bit lower in coming days. Platinum support is at \$1,485 and \$1,450, palladium support is at \$428 and \$420.

**By Walter de Wet**

## Energy

WTI is tracking the dollar ahead of the return of the US markets, with a weaker dollar seeing front month WTI trade back above \$73/bbl. With little in the way of economic data today, once the US opens we expect crude to look more towards the equities for direction rather than the dollar, with the equities providing a better proxy for general market sentiment.

Coal prices had a very quiet start to the week, due in part to the long weekend in the US. API2 for Q3-10 fell slightly, dropping \$0.25/mt to close at \$93.75 while Cal-11 climbed \$0.25/mt. API4 saw even less movement, with Q3-10 falling \$0.05 and Cal-11 remaining unchanged from Friday at \$94.75.

Following Australia's decision to reduce the planned profit tax on miners from 40% to 30%, Xstrata has restarted work on it's A\$6 billion Wandoan coal project, with a go-ahead decision expected in H2-2011. Elsewhere, Thai PTT is also looking at coal and expects to acquire stakes in at least two foreign coal mines this year. PTT runs Thailand's gas pipeline monopoly and controls over 30 other petroleum, gas exploration, petrochemical and refinery businesses.

Meanwhile, a heat wave in northern China has seen water and electricity demand hit record levels in Beijing. The eastern province of Zhejiang has ordered around 1000 companies involved in energy-intensive industries to halt or cut production for 15 days in order to alleviate pressure on the energy grid.

**By Leon Westgate**

## 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	4,404,850	4,410,775	-	5,925	-5,925	-224,050	273,500	6.21	64,962
Copper	441,700	444,500	50	2,850	-2,800	-60,625	34,225	7.75	62,648
Lead	189,350	189,625	-	275	-275	42,850	13,800	7.29	15,515
Nickel	122,172	122,514	-	342	-342	-35,838	5,088	4.16	18,355
Tin	16,765	17,035	10	280	-270	-10,000	1,375	8.20	5,156
Zinc	616,600	616,600	-	-	0	128,550	23,725	3.85	36,132

### Shanghai 3-month forward prices

### COMEX active month future prices

Metal	Open	Last	1d Change		Open	Close	Change	Change (%)
Aluminium	14,770	14,810	10	Ali May'10	-	-	-	-
Copper	51,850	52,250	-120	Cu May'10	292	294.85	3.25	1.11%
Zinc	14,960	15,235	140					

### ZAR metal prices (5 July 2010)

	Aluminium	Copper	Lead	Nickel	Tin	Zinc	ZAR/USD fix
Cash	14,808	49,878	13,410	145,412	133,601	13,670	7.7450
3-month	15,234	50,883	13,881	147,066	136,449	14,211	7.8645

## 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 (\$/bbl)	81.13	-0.36	81.79	-0.19	82.25	-0.32	83.76	-0.46	-	-
Gasoil 0.1% Rdam (\$/mt)	616.50	2.75	618.00	2.50	622.75	3.25	632.50	1.75		
NWE CIF jet (\$/mt)	660.33	-3.28	665.05	-4.06	671.73	-3.92	687.73	-4.32		
Singapore Kero (\$/bbl)	81.61	-0.56	82.79	-0.19	83.45	-0.32	85.31	-0.36		
3.5% Rdam barges (\$/mt)	392.50	0.00	395.00	0.25	397.50	0.25	406.00	0.25		
1% Fuel Oil FOB (\$/mt)	427.25	1.00	431.50	1.25	434.50	0.75	444.00	0.75		
Sing FO 380 Cargo (\$/mt)	416.25	1.00	415.25	-17.50	415.25	-17.50	415.25	-17.50		
Sing FO180 Cargo (\$/mt)	422.25	2.75	423.75	1.00	426.25	0.50	435.25	0.50		
Thermal coal	Q3-10		Q4-10		Q1-11		Cal 11		Cal 12	
API2 (CIF ARA)	93.75	-0.25	95.65	-0.10	97.90	0.25	100.00	0.25	106.75	0.25
API4 (FOB RBCT)	90.25	0.05	90.65	-0.30	93.40	0.00	94.75	0.00	100.25	0.25

## Precious metals

Forwards (%)	1-month	2-month	3-month	6-month	12-month		
Gold	0.49167	0.52500	0.56500	0.68000	0.77333		
Silver	0.71333	0.73333	0.75833	0.79833	0.79167		
USD Libor	0.34625	0.42938	0.53125	0.74344	1.16375		
Technical Indicators	30-day RSI	10-day MA	20-day MA	100-day MA	200-day MA	Support	Resistance
Gold	50.78	1,228.73	1,231.21	1,171.13	1,136.66	1,202.00	1,218.00
Silver	47.34	18.35	18.44	17.86	17.62	17.60	18.40
Platinum	40.58	1,536.05	1,550.29	1,611.60	1,528.52	1,500.00	1,550.00
Palladium	42.59	451.77	461.06	480.20	428.14	420.00	450.00
Active Month Future	COMEX GLD	COMEX SLV	NYMEX PAL	NYMEX PLAT	DGCX GLD	TOCOM GLD	CBOT GLD
	Jun'10	Jul'10	Jun'10	Jul'10	Jun'10	Feb'11	Jun'10
Settlement	1,208.40	17.8400	430.85	1,503.60	1,207.50	3,427.00	1,208.40
Open Interest	588,651	122,903	19,560	28,923	1,458	115,333	3,151
Change in Open Interest	2,034	4,351	56	187	0	5,123	0

Date: 5 July 2010

Sources: Standard Bank; LME; Bloomberg

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