FICC Research

Commodities: Daily

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Focus: Copper - bumpy ride ahead

Focus: Participants in this year's LME week were almost universally bullish on copper's medium and longer term prospects, even with prices above the $8,000 mark. We share that view, although we also expect to see significant price volatility ahead of the next FOMC meeting in early November.

- A recovery in the US dollar has been the main feature of the markets this morning, with that dollar strength seeing prices weaken across most the base metals complex this morning. The metals have stabilised ahead of US trade however, though the dollar remains in charge of short term price direction.
- The market focus has shifted from whether more QE will take place to how much QE is in the offing. We believe that the gold market is pricing quantitative easing of $500bn (based on the gold price's strong casual relationship with global liquidity and the Fed's balance sheet). We believe that a figure less than $500bn could see the gold price decline.
- Oil had a big down day on Friday, and a very short-lived recovery early afternoon during Bernanke's speech. The market had a realisation that strong real demand growth remains elusive, gave up chasing the QE2-fuelled rally in crude oil. Front-month Nymex WTI lost $1.44/bbl on Friday, while front-month ICE Brent finished $2.08/bbl cheaper.

Commodity price data (15 October 2010)

Base metals LME 3-month	Open	Close	High	Low	Daily change	Change (%)	Cash Settle	Change in cash settle	Cash – 3m
Aluminium	2,402	2,378	2,392	2,358	-33	-1.00%	2,368.00	-34	-33.75
Copper	8,375	8,401	8,395	8,295	-	0.31%	8,362.50	-50	-18.25
Lead	2,400	2,426	2,419	2,381	-7	1.06%	2,377.00	-25	-26.50
Nickel	24,295	24,040	23,999	23,350	-270	-1.05%	24,250.00	-105	-54.50
Tin	26,700	26,725	26,506	26,100	-200	0.09%	26,855.00	-745	28.00
Zinc	2,403	2,424	2,424	2,384	9	0.85%	2,380.00	-19	-30.00

Energy	Open	Close	High	Low	day/day	Change (%)
ICE Brent	83.05	81.69	83.10	81.53	-0.76	-0.93%
NYMEX WTI	81.38	80.51	81.44	80.35	-0.74	-0.92%
ICE Gasoil	703.25	696.75	705.50	696.00	-15.00	-2.15%
API2 Q4'10	99.30	99.40	-	-	0.10	0.10%
EUA Dec10	15.59	15.49	-	-	-0.10	-0.64%

Precious metals	AM Fix	PM Fix	High bid	Low offer	Closing bid	Change (d/d)	EFPs
Gold	1,377.25	1,367.50	1,385.50	1,363.00	1,371.00	-5.50	0.3/0.7
Silver	-	23.86	24.82	24.09	24.26	-0.17	0.0/2.0
Platinum	1,701.00	1,691.00	1,712.00	1,691.00	1,690.00	-13.00	3.5/5.5
Palladium	597.00	591.00	602.00	589.00	588.00	-11.00	1.0/3.0

Sources: Standard Bank; LME; BBG

Focus: Copper - bumpy ride ahead

Participants in this year's LME week were almost universally bullish on copper's medium and longer term prospects, even with prices above the $8,000 mark. We share that view, although we also expect to see significant price volatility ahead of the next FOMC meeting in early November.

Price-wise, copper appears to have run out of steam following its spectacular rally throughout September and October, predominantly due to a turnaround in the dollar. Open interest for copper has also moderated a little however, indicating that participants, perhaps nervous about the build in open interest, have been looking to take some profit. The red metal nevertheless remains well supported for the moment, though there are mixed signals from the physical market.

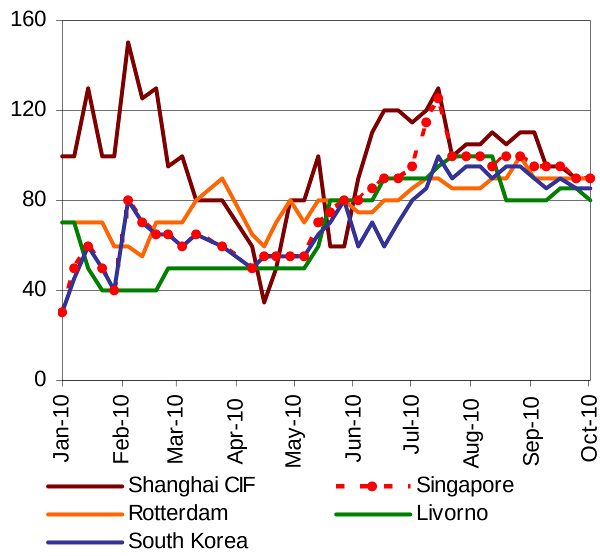
Physical premiums in Asia have softened recently. They are drifting sideways to lower on thin volumes and have yet to pick up following the Chinese holidays. While we believe China is generally de-stocked and needs to come back to the market, the premiums reflects a note of caution amongst Chinese consumers.

The strength in the Rmb vs. the dollar, and expectations of future dollar weakness, is another factor that may also delay that restocking activity until later in Q4. Consumers also seem unwilling to restock aggressively at what they regard as elevated price levels.

In the background, power curbs in China are also impacting on smelters and fabricators. This has seen TC/RC's recover as smelters face reduced capacity utilization rates, and is also likely responsible for the recent increase in SHFE inventory.

Given market consensus about copper's bullish prospects, its debateable whether any potential sell-off will trigger significant liquidation of positions. That said however, Chinese physical demand - the fundamental backbone of copper's past and future performance - may also take longer to re-emerge than expected.

Copper Physical Premiums (US$/mt)



Source: *Standard Bank, Fast Markets*

Therefore, with all eyes on the next wave of QE, copper looks set for a bumpy end to the month, with technical signals and the dollar in charge and the physical market temporarily relegated to the sidelines.

By Leon Westgate

Base metals

A recovery in the US dollar has been the main feature of the markets this morning, with that dollar strength seeing prices weaken across most the base metals complex this morning. The metals have stabilised ahead of US trade however, though the dollar remains in charge of short term price direction.

Data-wise, its a fairly quiet start to the week with the main macroeconomic figures this afternoon being the US TIC data and September's Industrial Production (expected +0.2%). Aside from the macro data, the likes of Citigroup and Apple are reporting their Q3 earnings, with any reaction from the equity markets potentially spilling over into the commodities.

Copper came under pressure overnight on the back of a stronger dollar, before picking back up heading into the afternoon. Turnover has been solid rather than spectacular, though the pullback in prices, towards $8,300, did spark some buying activity. Overall however, the market remains fairly quiet with the dollar and other exogenous factors in charge of price direction for the moment. Meanwhile, the options market suggests that interest continues to grow in terms of copper's potential upside, with $10,000 Calls being traded for both Feb-11 and Mar-11.

Aside from copper, turnover in the other base metals has been disappointing, with only nickel seeing decent volumes build up. The metal continued to come under pressure this morning, following on from Friday afternoon's sell-off, though a retracement in the dollar helped the metal dig its heels in around $23,400 this morning.

By Leon Westgate

Precious metals

The dollar has been strengthening against the euro and also on a trade-weighted basis since Friday afternoon following statements by the Fed regarding its view on the US economy and the need for further quantitative easing (QE). However, the market focus has shifted from whether more QE will take place to how much QE is in the offing. We believe that the gold market is pricing quantitative easing of $500bn (based on the gold price’s strong casual relationship with global liquidity and the Fed’s balance sheet). We believe that a figure less than $500bn could see the gold price decline.

US break-even inflation (as derived from US bond yields) is still rising. The bond market is pricing low inflation for the next two years, rising steadily towards and average inflation rate of 2% over the next 10 years. The 10y breakeven inflation rate is now just above 2%. The 5y breakeven inflation is at 1.6% and 2y breakeven inflation at 1%. If the average inflation rate over the next two years in the US is going to be 1% (as priced by the bond market) and the US Fed implicitly targets 2% inflation, we expect interest rates to remain low for the entire 2011 and possibly 2012. This morning the futures market assigns a probability of 82% of no rate increase until at least Sep'11. Low rates and rising liquidity are positive for gold.

Short term, we believe that dips in the gold price will be bought by seasonal jewellery demand in the run-up to Diwali (which ends 5 November). At the same time, we have the FOMC meeting on 3 November which is keeping investment interest alive. We remain cautious on gold post- 5 November. The risk remains that the Fed could disappoint in the size of QE which may be amplified by seasonal jewellery demand which should fall away in November.

Friday's CFTC data indicates net spec positions in many commodities remain high. But as a percent of open interest net non-commercial longs have actually declined for gold and silver. The decline comes on the back of rising open interest rather than falling net long spec positions. By this measure silver and gold are looking less overextended than a week ago — consistent with our view that gold (and silver) should be bought on dips in the run-up towards the first week of November.

Gold support is at $1,358 and $1,348. Resistance is at $1,380 and $1,395. Silver support is at $23.95 and $23.60. Resistance is at $27.75 and $25.20.

By Walter de Wet

Energy

Oil had a big down day on Friday, and a very short-lived recovery early afternoon during Bernanke’s speech. The market had a realisation that strong real demand growth remains elusive, gave up chasing the QE2-fuelled rally in crude oil. Front-month Nymex WTI lost $1.44/bbl on Friday, while front-month ICE Brent finished $2.08/bbl cheaper.

The latest CFTC reported showed net non-commercial length for Nymex WTI continued to climb, albeit at a much slower pace than the previous three weeks, edging towards the record lengths appeared in April. Net non-commercial length on RBOB also continued its increase, while Heating Oil net non-commercial length was cut back slightly.

Perhaps more significant, given the focus of the crude oil market on broader macro economic environment, is the E-Mini S&P 500 net non-commercial short position that increased by 25% for futures only, and 30.5% increase on net short for futures and options combined. Combined with the large net long non-commercial position in crude oil this raises a red flag for any bull play in oil, given the recent close correlation between S&P 500 index and oil. We see increasing likelihood a downward correction in oil within a $75 – $84 trading range.

Besides the normal US oil inventory data this week, the oil market should look at two key cyclical sectors in the US this week. One is the industrial production report this afternoon, the other is housing starts on Tuesday. On Thursday, we will also have Eurozone consumer confidence index. These sector-data is important for the broader global economic outlook and any weakness may result in crude oil trading lower.

As the anticipated QE2 has so far failed to lift oil out the trading range, the market needs to see real demand pick up from the OECD countries to break out on the upside. This is unlikely to happen very soon. We maintain out view that oil will stay inside the above trading range well into Q4.

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	4,312,375	4,313,975	4,025	5,625	-1,600	-316,525	209,550	4.86	231,521
Copper	370,450	371,025	300	875	-575	-131,875	22,700	6.13	122,988
Lead	197,625	197,700	175	250	-75	51,125	6,525	3.30	43,113
Nickel	123,822	124,056	60	294	-234	-34,188	4,056	3.28	31,684
Tin	12,525	12,525	35	35	-	-14,240	280	2.24	5,241
Zinc	607,325	608,250	-	925	-925	119,275	39,375	6.48	63,272

Shanghai 3-month forward prices				COMEX active month future prices				
Metal	Open	Last	1d Change		Open	Close	Change	Change (%)
Aluminium	16,390	16,450	-50	Ali Dec'10	-	-	-	-
Copper	63,140	63,260	-300	Cu Dec'10	384	378.85	-5.05	-1.32%
Zinc	19,245	19,390	-25					

ZAR metal prices (15 October 2010)							
	Aluminium	Copper	Lead	Nickel	Tin	Zinc	ZAR/USD fix
Cash	16,114	56,907	16,175	165,021	182,748	16,196	6.8050
3-month	16,417	57,999	16,745	165,967	184,504	16,731	6.9038

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 ($/bbbl)	93.19	-0.79	93.72	-1.71	94.10	-1.81	95.57	-1.54	-	-
Gasoil 0.1% Rdam ($/mt)	696.75	-15.00	698.50	-14.75	701.75	-14.75	709.25	-13.50		
NWE CIF jet ($/mt)	762.24	-4.52	763.95	-8.25	767.01	-9.00	783.22	-10.50		
Singapore Kero ($/bbl)	94.71	-0.77	94.82	-1.66	95.20	-1.76	96.72	-1.49		
3.5% Rdam barges ($/mt)	453.70	-1.70	452.25	-3.25	456.75	-1.25	461.97	-5.67		
1% Fuel Oil FOB ($/mt)	470.33	-0.12	474.50	-	479.50	-0.50	489.97	-3.42		
Sing FO 380 Cargo ($/mt)	100.15	-	100.15	-	100.15	-	100.15	-		
Sing FO180 Cargo ($/mt)	474.44	-0.84	477.00	-1.25	481.00	-1.50	486.47	-5.42		
Thermal coal	Q4-10		Q1-11		Q2-11		Cal 11		Cal 12	
API2 (CIF ARA)	99.40	0.10	100.05	-0.25	100.75	-0.25	101.35	-0.30	107.15	-0.40
API4 (FOB RBCT)	92.20	0.10	95.35	-0.05	96.05	-0.15	96.65	-0.20	101.25	-0.40

Precious metals

Forwards (%)	1-month	2-month	3-month	6-month	12-month		
Gold	0.37000	0.38800	0.41200	0.47000	0.51000		
Silver	0.56000	0.56000	0.57000	0.59000	0.61400		
USD Libor	0.25625	0.27297	0.28906	0.45250	0.76663		
Technical Indicators	30-day RSI	10-day MA	20-day MA	100-day MA	200-day MA	Support	Resistance
Gold	66.44	1,355.26	1,328.77	1,243.65	1,190.73	1,351.00	1,376.00
Silver	69.12	23.52	22.54	19.38	18.41	23.67	24.47
Platinum	58.19	1,697.60	1,672.20	1,571.41	1,591.90	1,671.00	1,700.00
Palladium	57.98	587.30	572.55	498.88	486.10	571.00	590.00
Active Month Future	COMEX GLD	COMEX SLV	NYMEX PAL	NYMEX PLAT	DGCX GLD	TOCOM GLD	CBOT GLD
	Dec'10	Dec'10	Jan'11	Jan'11	Dec'10	Aug'11	Dec'10
Settlement	1,356.80	23.8750	572.00	1,695.40	1,356.70	3,550.00	1,355.60
Open Interest	638,283	153,657	24,853	39,051	2,144	103,068	2,285
Change in Open Interest	-10,947	3,004	-323	133	145	587	9

Date: 15 October 2010

Sources: Standard Bank; LME; Bloomberg

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