FICC Research

Commodities: Daily

20 October 2010

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Focus: Aluminium forward curve/dog leg

Focus: The aluminium forward curve is looking more like a dog-leg at the moment than a curve as such, with tightness emerging around the Jan-11 date and with most of 2011, in particular Dec-11 remaining under pressure and looking rather suppressed.

- Yesterday's announcement by the Chinese government that it was raising interest rates spooked the market, causing a knee-jerk sell-off across the commodities as participants looked to take risk off the table. The impact from the news was relatively short lived however with the metals finishing off their intraday lows.
- Investors are still buying dips in the gold price. We expect this to continue for the next two weeks. As for seasonal jewellery demand, we expect it to remain robust until the first week of November.
- The oil market took a big knock yesterday as China raised both lending and deposit rates by 25 bps. Given the lagging effect of the interest rate, these increases is unlikely to have much immediate effect on the economy and/or energy demand. Nevertheless, all oil front-month future contracts fell by more than 4% on the day. We believe that this signals an oil market that is lacking the support of supply and demand fundamentals.

Commodity price data (19 October 2010)

Base metals LME 3-month	Open	Close	High	Low	Daily change	Change (%)	Cash Settle	Change in cash settle	Cash – 3m
Aluminium	2,423	2,356	2,375	2,340	-55	-2.77%	2,356.50	8	-33.50
Copper	8,405	8,265	8,320	8,170	-183	-1.67%	8,295.00	-46	-19.25
Lead	2,405	2,400	2,425	2,384	0	-0.21%	2,377.00	4	-26.75
Nickel	23,725	23,480	23,667	23,250	-350	-1.03%	23,505.00	-165	-69.00
Tin	26,524	25,900	26,500	26,190	-126	-2.35%	26,545.00	5	10.00
Zinc	2,406	2,394	2,422	2,366	-33	-0.50%	2,376.50	11	-33.00
Energy	**Open**	**Close**	**High**	**Low**	**day/day**	**Change (%)**			
ICE Brent	80.92	82.17	82.36	80.75	1.07	1.30%			
NYMEX WTI	79.48	80.52	80.60	79.35	1.03	1.28%			
ICE Gasoil	692.75	700.50	701.50	691.75	-3.50	-0.50%			
API2 Q4'10	100.30	99.70	-	-	-0.60	-0.60%			
EUA Dec10	15.33	15.07	-	-	-0.26	-1.70%			
Precious metals	**AM Fix**	**PM Fix**	**High bid**	**Low offer**	**Closing bid**	**Change (d/d)**	**EFPs**		
Gold	1,367.75	1,339.00	1,370.85	1,333.00	1,335.50	-36.00	0.3/0.7		
Silver	-	23.69	24.48	23.46	23.77	-0.61	-1.0/1.0		
Platinum	1,695.00	1,672.00	1,700.00	1,683.00	1,687.00	-5.00	3.5/5.5		
Palladium	586.00	571.00	589.50	581.00	583.00	-4.00	1.0/3.0		

Sources: Standard Bank; LME; BBG

Focus: Aluminium forward curve/dog leg

The aluminium forward curve is looking more like a dog-leg at the moment than a curve as such, with tightness emerging around the Jan-11 date and with most of 2011, in particular Dec-11 remaining under pressure and looking rather suppressed.

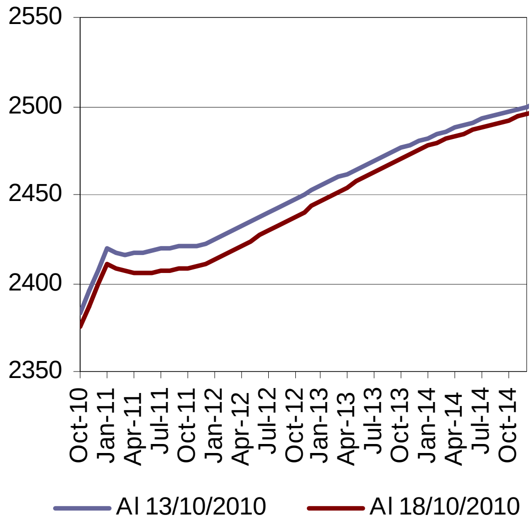
In terms of the nearby tightness, from January to March, the backwardation in this portion of the curve has been pretty stable, suggesting there may be further tightness to come as we head into 2011.

Whether we see a repeat of the market conditions seen in the August-September dates earlier this year, when the nearby backwardation flared out, is open to debate, though we remain cautious nevertheless.

Perhaps more interestingly however is the way that the portion of the curve encompassing 2011 is being suppressed. Also worth noting is that with the latest wobble in prices, open interest for Mar-11, Jun-11, Sep-11 and Dec-11 also ticked higher, suggesting new short positions were being added. This perhaps indicates that the recent price weakness sparked some producer selling interest.

While we expect the nearby tightness to remain a feature of the market, the flat portion of the forward curve out to Dec-11 is perhaps indicative of the uncertainty over future prices. Once there is more clarity regarding price direction, perhaps after the FOMC statement in early November, we would expect to see the pressure towards the back end of 2011 start to dissipate.

LME Aluminium forward curves (US$/mt)



Source: Standard Bank, LME

By Leon Westgate

Base metals

Yesterday's announcement by the Chinese government that it was raising interest rates spooked the market, causing a knee-jerk sell-off across the commodities as participants looked to take risk off the table. The impact from the news was relatively short lived however with the metals finishing off their intraday lows. Copper saw near record turnover build up on LME Select during Tuesday afternoon (over 26,000 lots), with good two way interest indicating that many participants saw the sell-off as a buying opportunity.

A weaker dollar has helped the metals continue to stabilise and recover heading into Wednesday afternoon. However, with little in the way of macroeconomic data, and with the Q3 earnings reporting season hitting its stride, the US equity markets will likely dictate price direction during the afternoon session.

Copper came under heavy pressure on Tuesday afternoon, following China's 25 basis point increase to both its lending and deposit rates. What was interesting however was a surge in volumes, as the sell-off was met with very strong buying activity. Copper closed less than 3% lower from the previous day's close, with over 26,000 lots trading on-line in the process.

Wednesday has seen copper come under pressure initially, briefly trading below $8,200 overnight before recovering on the back of a weaker dollar heading into the morning. Solid, albeit unspectacular volumes have built up, though the metal is treading water around $8,250 ahead of US trade. Inventory-wise, on-warrant LME stocks fell 2,350 mt this morning, due primarily to a large 2,900 mt jump in cancelled warrants in New Orleans.

Aluminium prices have also stalled heading into the afternoon, with the metal trading more or less around Tuesday's closing levels. Meanwhile, stories surrounding smelter cutbacks in China have continued to emerge. While the cuts are a potentially bullish factor for the market, we note that many operations were already running below capacity and that the incremental impact is, in some cases, quite small. We also note that fabricators are likely to be impacted by the power curbs. The question therefore becomes whether one sector is impacted by the curbs more than the other.

Elsewhere, lead prices have recovered strongly after yesterday's sell-off, with the market also taking a 1,200 mt increase in on-warrant stocks this morning in its stride. The main location for the increase was Johor, where on-warrant stocks climbed 1,000 mt.

By Leon Westgate

Precious metals

Investors are still buying dips in the gold price. We expect this to continue for the next two weeks. As for seasonal jewellery demand, we expect it to remain robust until the first week of November.

We maintain the gold price at $1,350 is consistent with quantitative easing by the Fed of $500bn. Anything less may see the gold price lower (Commodities Daily dated 12Oct'10). Empirically, we find the long-term causal drivers of gold are *global liquidity* and *real interest rates* (Commodities Insight: Global liquidity and real interest rates support gold of 11Aug'10). Lately, gold has diverged by some margin from the long-term trend provided by these causal drivers. Divergence by gold from this long-term trend is not unusual, but the speed, size and timing of its divergence coincide with the increasing expectations for further QE. We find that for global liquidity to be consistent with the current gold price around $1,350, the Fed would have to expand its balance sheet by $500bn.

Gold support is at $1,331 and $1,322. Resistance is at $1,346 and $1,352.

We remain bullish on platinum and palladium. Investor interest has also picked up in recent weeks, with both platinum ETFs and palladium ETFs seeing a rise in metal holdings. Platinum ETF holdings now stand at 1.014m oz (up from 971K oz at the start of October), while palladium ETF holdings are at 1.838m oz (up from 1,683m oz at the start of October). Our target for platinum remains $1,800 and $650 for palladium early in 2011. Platinum support is at $1,668 and $1,660. Resistance is at $1,720. For palladium, we look for a break above $595 to push us towards this target. Support lies at $571.

By Walter de Wet

Energy

The oil market took a big knock yesterday as China raised both lending and deposit rates by 25 bps. Given the lagging effect of the interest rate, these increases is unlikely to have much immediate effect on the economy and/or energy demand. Nevertheless, all oil front-month future contracts fell by more than 4% on the day. We believe that this signals an oil market that is lacking the support of supply and demand fundamentals. The development yesterday was in stark contract to that on Monday when the oil market simply brushed aside the negative US September industrial production index, the first decline since the US recession ended in June 2009. Our research shows a strong correlation between oil demand and industrial production, as one would expect.

The latest API inventory number released yesterday were bearish. According to the API, crude inventories built 2.3mbbl, gasoline inventory was broadly flat, while middle distillate had a draw of 0.85mbbl for the week ending 15 Oct'10. For the DOE release today, the market consensus is crude a build of 1.5mbbl, a draw in gasoline of 1.5mbbl, while distillate inventory is expected to decline by 1.0mbbls. In comparison, our forecast is a build for crude of 2.5mbbl, a draw for gasoline and distillates of 1.8mbbl and 0.25mbbl respectively.

Front-month WTI closed $3.59/bbl lower, at $79.49/bbl yesterday. Technically, all future contracts on oil closed below their short term (5, 8 and 13 days) moving average and stochastics was firmly in the negative yesterday. This morning, oil recouped some of the losses, as dollar reversed the upward trend over the last three trading days. November WTI expires today. The more relevant Dec WTI needs to close above the resistance of $82.10/bbl to reverse the downward correction.

Contrary to the rest of the energy complex, thermal coal market held up well yesterday. October Richards Bay coal price (API4 FOB) closed at $90.45/mt, $0.70/mt higher than the previous session. Front-month coal for delivery into ARA (API2) finished $0.50/mt higher at $98.50/mt.

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	4,329,825	4,316,325	18,075	4,575	13,500	-299,075	205,025	4.74	459,590
Copper	370,750	369,950	1,350	550	800	-131,575	25,350	6.84	141,344
Lead	198,225	198,300	200	275	-75	51,725	5,000	2.52	40,759
Nickel	124,572	124,104	780	312	468	-33,438	3,816	3.06	34,266
Tin	12,690	12,470	225	5	220	-14,075	455	3.59	4,531
Zinc	606,425	607,300	0	875	-875	118,375	38,625	6.37	57,641

Shanghai 3-month forward prices				COMEX active month future prices				
Metal	Open	Last	1d Change		Open	Close	Change	Change (%)
Aluminium	16,160	16,300	-240	Ali Dec'10	-	-	-	-
Copper	61,990	62,410	-1,340	Cu Dec'10	376	377.35	1.60	0.43%
Zinc	18,980	19,200	-380					

ZAR metal prices (19 October 2010)							
	Aluminium	Copper	Lead	Nickel	Tin	Zinc	ZAR/USD fix
Cash	16,397	57,717	16,539	163,548	184,700	16,536	6.9580
3-month	16,625	58,323	16,936	165,689	182,766	16,894	7.0566

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 ($/bbbl)	92.72	-0.59	92.54	-1.80	93.09	-1.69	94.59	-1.35	-	-
Gasoil 0.1% Rdam ($/mt)	700.50	-3.50	702.00	-3.50	705.50	-3.25	710.50	-4.75		
NWE CIF jet ($/mt)	758.07	-5.95	753.20	-14.35	756.26	-13.83	766.47	-12.25		
Singapore Kero ($/bbl)	94.39	-0.42	93.94	-1.60	94.39	-1.59	95.79	-1.35		
3.5% Rdam barges ($/mt)	453.14	-2.35	449.25	-7.75	451.75	-7.50	461.31	-7.13		
1% Fuel Oil FOB ($/mt)	468.56	-1.61	470.25	-7.25	475.25	-7.25	488.56	-6.63		
Sing FO 380 Cargo ($/mt)	100.15	-	100.15	-	100.15	-	100.15	-		
Sing FO180 Cargo ($/mt)	473.44	-2.01	473.25	-7.25	476.75	-7.50	485.56	-7.63		
Thermal coal	Q4-10		Q1-11		Q2-11		Cal 11		Cal 12	
API2 (CIF ARA)	99.70	-0.60	100.60	-0.70	101.30	-0.80	101.85	-0.85	107.55	-1.05
API4 (FOB RBCT)	92.70	-0.40	96.10	-0.60	96.90	-0.80	97.40	-0.80	101.65	-0.95

Precious metals

Forwards (%)	1-month	2-month	3-month	6-month	12-month		
Gold	0.34000	0.34800	0.37200	0.43200	0.48600		
Silver	0.47000	0.48000	0.48200	0.51800	0.54200		
USD Libor	0.25625	0.27172	0.28906	0.45250	0.76550		
Technical Indicators	30-day RSI	10-day MA	20-day MA	100-day MA	200-day MA	Support	Resistance
Gold	61.24	1,354.70	1,334.05	1,246.00	1,192.81	1,321.00	1,365.00
Silver	66.26	23.67	22.81	19.49	18.46	23.15	24.38
Platinum	57.63	1,692.50	1,677.13	1,573.93	1,592.94	1,656.00	1,698.00
Palladium	58.53	586.88	576.59	501.34	487.67	566.00	589.00
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	1,341.50	23.7100	578.00	1,677.60	1,342.80	3,511.00	1,343.00
Open Interest	638,372	151,466	24,733	38,965	2,039	99,476	2,288
Change in Open Interest	-2,013	802	65	23	105	1,531	8

Date: 19 October 2010

Sources: Standard Bank; LME; Bloomberg

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