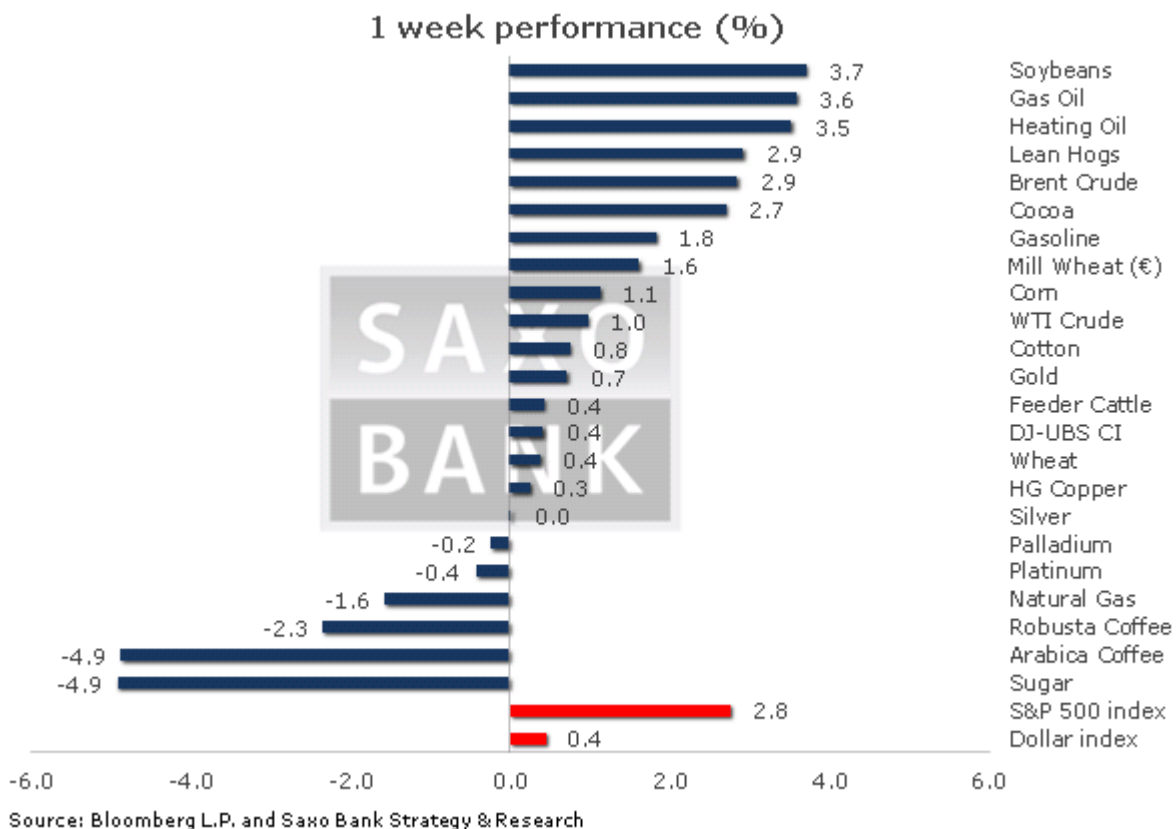


Damage to US crop confirmed while oil rally runs out of steam

Prices were generally higher across the different commodity sectors this week, with weather and geopolitics still having the upper hand. There was a limited focus on weak economic growth across the world, which otherwise would argue against rising prices. However, following the month long rally, attention will increasingly return to slowing demand. The sustainability of the recent rally, especially in energy, can be put into question.

The DJ-UBS Commodity index rose by 0.4 percent. It has now rallied during six of the past seven weeks as the agriculture and the energy sector have experienced strong gains.



Crude oil stubbornly high as supply disruptions persists

The price of North Sea Brent crude rallied for a second week in a row and in the process recovered more than 60 percent of the March to June sell-off. The bullish drivers are currently three fold: a drop in supply from the North Sea during the August to September field maintenance season, geo-political tensions from hot spots in Syria, Iran and Libya which also leaves the supply side exposed, and finally continued expectations for additional quantitative easing, which once again have been attracting financial investors into energy.

As a result of the reduced North Sea production, the Brent crude spot month premium over WTI crude has widened to 20 dollars and the spread between the first over the second Brent futures

contract has moved from a discount to a premium of 1.6 dollars per barrel during July and August, which is an expression of tightness in the spot market. Daily loadings in September of the three North Sea crudes which make up the Brent crude benchmark are expected to drop to the lowest level in more than five years.



Brent crude spot month – Source: Saxo Bank

Geo-political tension is lurking just below the surface, leaving the supply side exposed to sudden reductions. At the moment we have several hotspots, which individually and combined add to the sense of unease across oil markets. In recent days and weeks we have seen the situation in Syria deteriorate even further. This combined with skirmishes in Libya and the ongoing embargo against Iranian oil exports leaves oil markets worried about additional supply tightness near term. The Iranian oil embargo has also resulted in Iraq now pumping more than Iran for the first time in more than 20 years.

On a negative note, OPEC in its monthly report saw 2013 oil demand growth slowing compared to 2012, with the risk skewed to the downside as a gloomier picture in Europe in particular could reduce the forecast by up to 20 percent. Other non-supportive news for oil came from China, which saw a collapse in its export growth for July. China's net oil imports shrank to the lowest level this year.

All in all the three bullish drivers mentioned have collectively helped drive oil prices higher, despite a lack of support from the level of global activity. Until we see solid signs that the global economic outlook has improved – and thereby also the demand for oil improved – we will stick to our Q3 forecast of the Brent crude price later this year moving back towards 105 dollars.

Gold busy going nowhere

With liquidity at a premium during the holiday month of August, where many traders are away from their screens, the primary activity has been in the hands of short-term traders looking for small movements to benefit from. With the lack of any major spark to push at boundaries, gold continues to find itself confined in a tighter and tighter range.

The price action during the week, however, still points towards an underlying positive sentiment, as sell-offs have been met with instant buying. With the dollar finding some support again following a period of position adjustments, especially versus the euro where short covering has been seen, the headwind from this will continue to frustrate bulls looking for higher prices. So while we wait for the spark, which could come from increased worries about inflation as food prices continues to rise, we should expect continued range trading with focus on the key levels at 1640 to the upside and 1570 and 1540 to the downside.



Spot gold – Source: Saxo Bank

Sugar bucks the trend of rising food prices

The price of sugar rallied hard during July and helped drive the UN FAO sugar index up by more than 11 percent during the month. The rally was driven by a slower-than-expected start to the Brazilian harvest as rain hampered the process, coupled with the prospect of lower production in India due to a poor outlook for the monsoon. This raised concerns that the projected 2012/13 production surplus would not materialise. Money managers jumped on the story, not least helped by the bullish attitude towards agriculture commodities in general.



Sugar #11, Oct12 – Source: Saxo Bank

Since reaching a peak of 24 cents per pound, the price has been falling hard, especially following the technical break below 22 cents, and this week the price slumped below 21 cents on continued long liquidation. The net non-commercial or speculative position in NY Sugar for the week ending July 31 stood at 153,000 contracts (17.1 billion pounds), almost equalling the highs seen in March 2012 and September last year.

Improving weather conditions in Brazil following an easing of the wet conditions has triggered a pick-up in the harvest and helped reduce export delays, while industry officials in India still expect that the country will be able to export sugar during the 2012/13 season despite a monsoon that is currently 17 percent below the average. Weather concerns, however, still linger and these could eventually steal the focus once more. While speculative traders exit unwanted long positions the price of sugar risks overshooting to the downside.

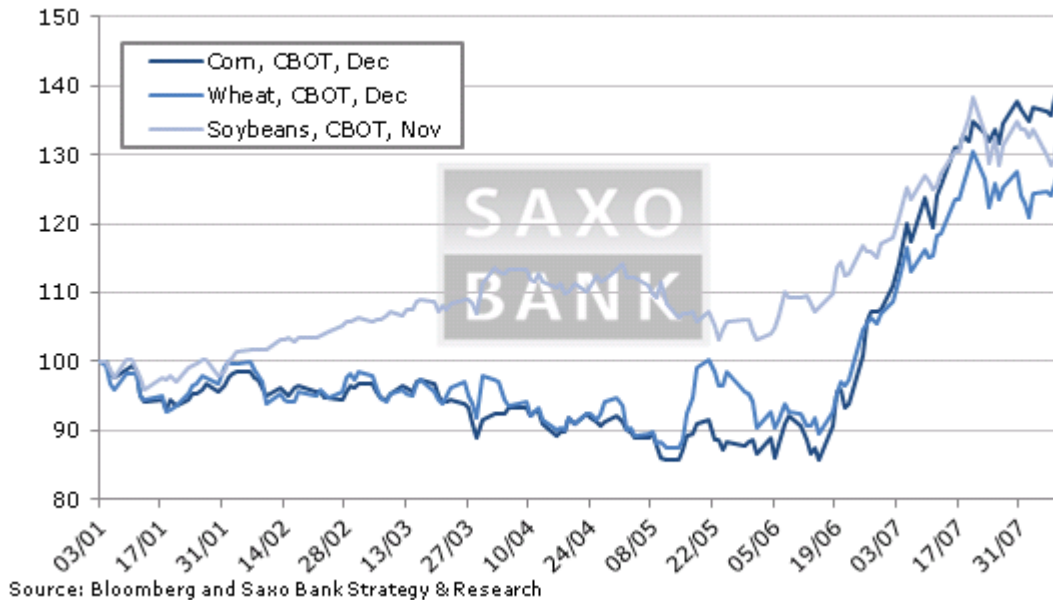
US government report sheds first light on extent of crop damage

The most eagerly awaited “World Agriculture Supply and Demand Estimates” report for many years on Friday gave the first proper picture of the damage to US crop production caused by the worst drought in more than 50 years. In it the United States Department of Agriculture, after having surveyed 27,000 farmers, downgraded their estimates for 2012/13 corn production by 17 percent and soybeans by 11.7 percent compared with a month earlier.

The report thereby confirms the fears about limited stocks of corn and soybeans towards the end of this crop season. In order to preserve stocks, demand destruction will have to be seen, something that can only really be achieved by seeing continued high prices. On that basis we could near term see prices retrace a bit, as much positioning had already occurred on the basis of weak production data. Soybeans remains the crop with the tightest supplies and this could eventually trigger some soybean outperformance and see the ratio between the two crops move up from its current level of 2 (soybean price twice as expensive as corn).

Attention may also soon turn to South America and Australia as they embark on their spring planting, and the hope is that elevated prices will trigger a massive response from farmers in the region. Wheat production and ending stocks were both better than expected, but with the main focus in wheat markets now on Russia’s dwindling production and potential feed switching from corn, the price may also stay supported following some initial weakness.

Relative performance of new crop (YTD)

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