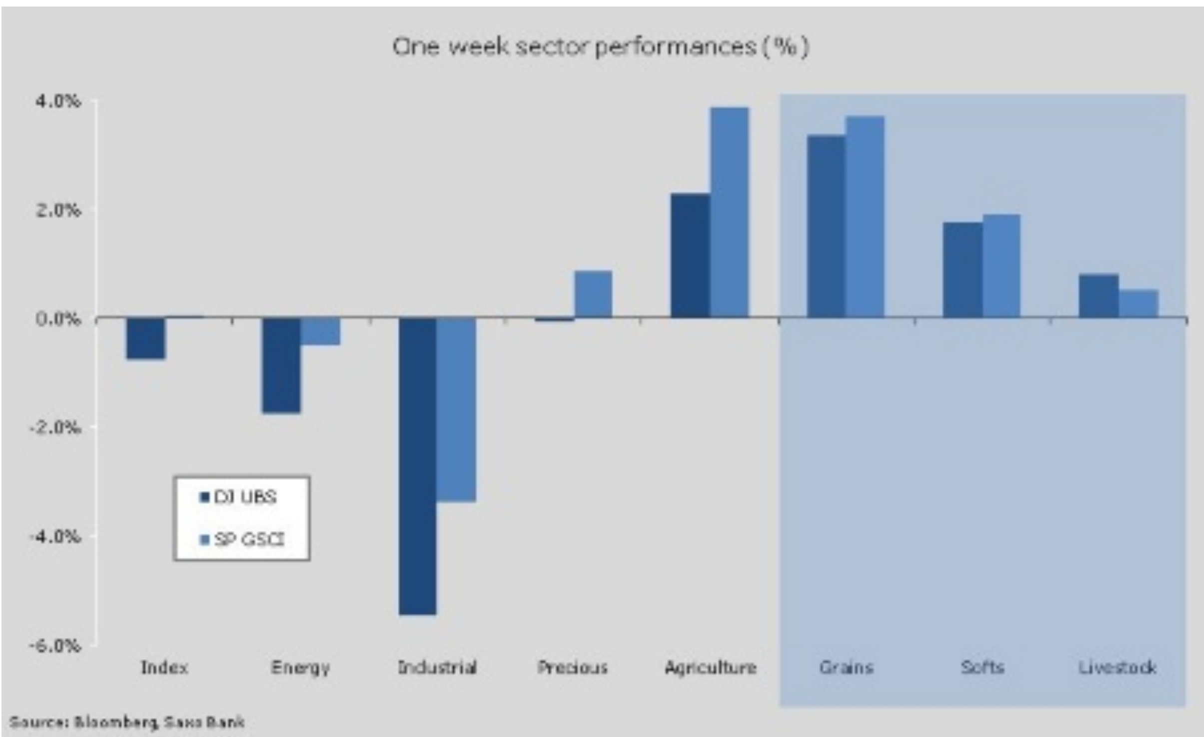
Central bank action off-setting sluggish data

The cut in interest rates by the European Central Bank to an all-time low, together with the US Federal Reserve maintaining its asset purchase programme, has been the main supporting features this week ahead of the monthly US job report later today. Earlier in the week, a worse-than-expected manufacturing PMI from China and a record weekly build in US crude inventories had the markets reeling, at least for while. In the agriculture space, wet and cold conditions in the US Midwest have lent support to the price of key crops, especially corn and wheat, as the planting progress is running much behind the normal pace.

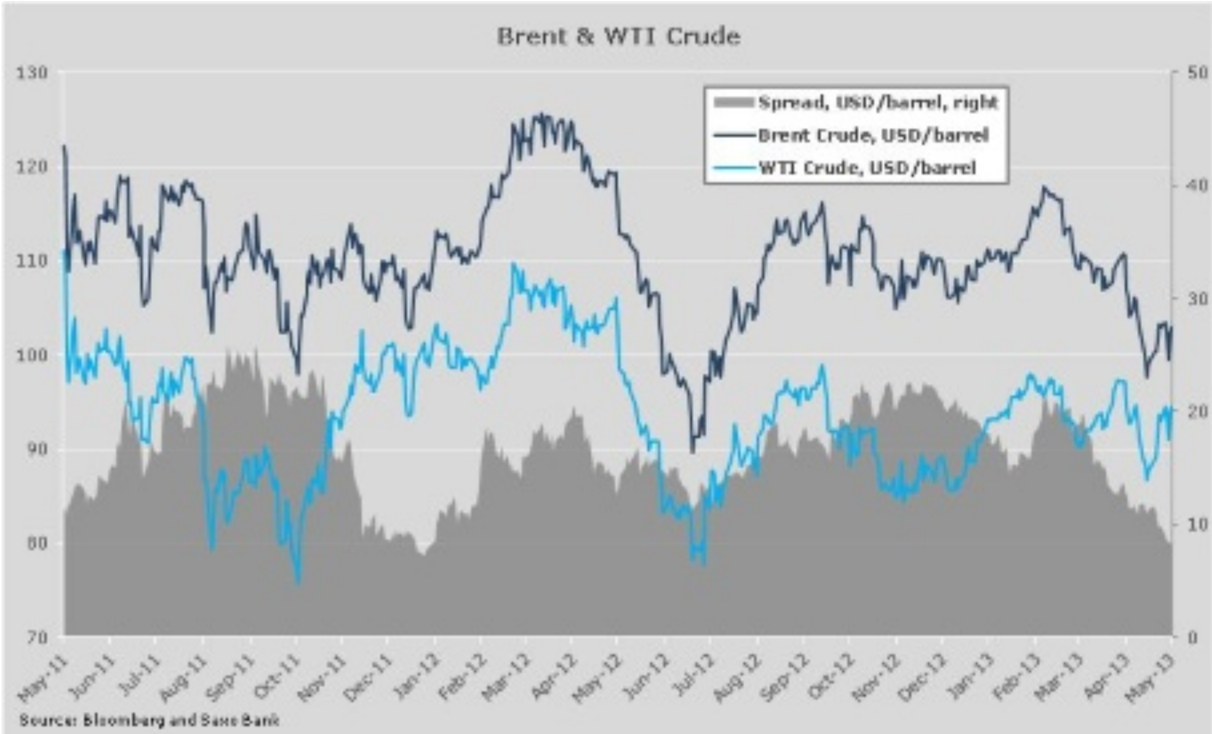
As seen below, the laggard was the industrial metal sector, which did not find much to cheer about considering the softness seen in Chinese economic activity. The energy sector also suffered losses primarily driven by natural gas and gasoline. Precious metals continue their tentative recovery, led by palladium but also gold, which, at the time of writing, is on track for its second week of gains as the tug-of-war between buyers in the physical market and sellers in the paper market (Exchange Traded Products and futures) continues.



US corn and wheat futures were the best performing commodities this week as the above mentioned wet spring weather has made it increasingly difficult for growers to get into the fields with their heavy machinery. Any further delay to the corn planting carries the potential of growers switching to soybeans, especially after mid-May, and this could alter the projection for corn inventories this autumn and help support the price further. As a result of this, the ratio between November soybeans and December corn has contracted from 2.31 to 2.16 as soybeans, which have a shorter growing season, could benefit from higher production and see the price lag behind that of corn.

Natural gas is the worst-performing commodity this week after the price dropped the most in nine months on Thursday, at least temporarily halting a rally that had been ongoing since mid-February. The 7 percent sell-off was triggered by a bigger-than-expected build in weekly stockpiles following a prolonged period of where consumption often exceeded expectations thereby helping drive the price higher. Momentum, which had been slowing for the past week, turned negative and traders may want to look for support down towards 3.85 USD per therm from the current level of about 4 USD per therm.

Crude oil markets recovered strongly from a mid-week sell-off following the biggest weekly build in US crude inventories on record. Increased imports saw oil flood into the Gulf coast area, while the bottleneck problems in the US Midwest around the Cushing, the delivery hub for WTI crude, saw a decent reduction, helping the discount to Brent crude contract further. WTI's discount to Brent has contracted rapidly since February and this week it reached 8.7 USD/barrel, the lowest level since December 2011. Having once again found support below 100 USD/barrel Brent crude has been looking for resistance and this has the potential of carrying it as high as 106.50 over the coming weeks. Demand is expected to pick up in the autumn and current lower-than-average price levels are only being maintained by OPEC's continued production above its stated target of 30 million barrels per day. Any moves below USD 100, therefore, has the potential of being short-lived.



Gold survived a mid week sell-off and is on track to record a second week of gains following the dramatic sell-off that hit the market back in April. An interest rate cut in Europe and continued asset purchase by the US Federal Reserve together with weak macroeconomic data lend support. Physical buying has been another strong feature lending support, but up against this the world of Exchange Traded Products (ETPs) continue to see gold holdings being reduced. This is probably driven by institutional accounts, which accounts for about half of the investments in the SPDR Gold Trust, the world's largest. Hedge funds have also been selling into the recent rally resulting in the second-biggest short position on record as they shift their focus, at least for now, towards other asset classes in the belief that renewed upside is limited.

The combined selling from ETPs and the reduction in net-long futures positions held by hedge funds since the beginning of the year amounts to almost 1,000 tonnes of gold. Unless we see these two segments return to the buy side, further upside seems limited at this stage. However, should we manage to reclaim the 1,525 USD/oz area, hedge funds would probably begin to reduce short position and that has the potential of carrying gold higher, potentially as high as 1,585 USD/oz, which we believe could be the near-term peak.

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