Weekly Commodity Update
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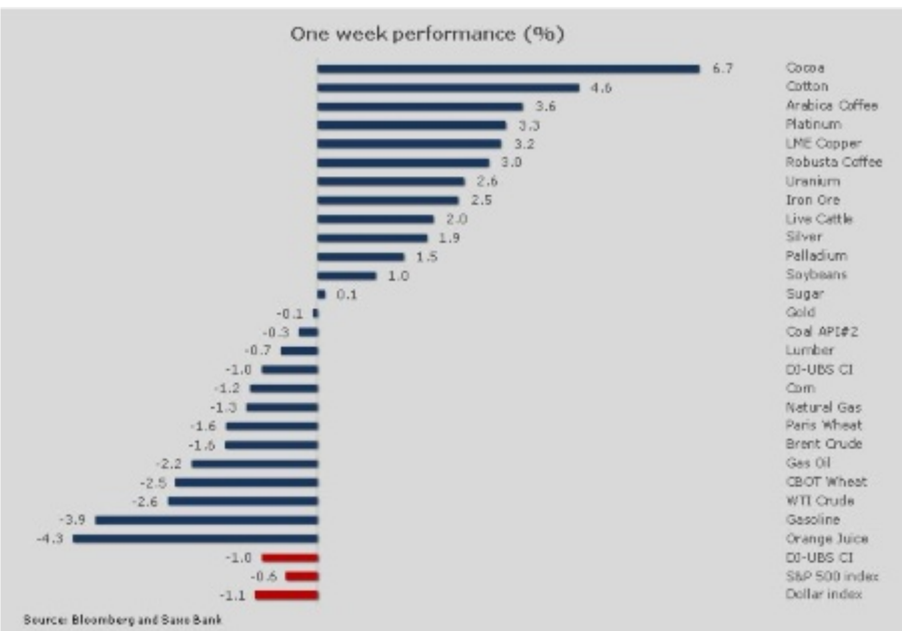
China data lifts industrial metals - Oil lower

China's commodity imports recovered strongly in July with strong increases seen in energy and metals. Whether this is a sign of a pickup in activity or just a buildup in stocks remains to be seen. Industrial metals nevertheless received a boost with copper seeing a significant amount of short-covering which also positively impacted silver and to a lesser extent, gold. Oil markets, however, went the other way led by gasoline after weekly inventory data raised doubts about whether demand for gasoline from US motorist would be strong enough to absorb the increased production seen during July.

Overall, both of the major commodity indices still recorded losses with the sell-off in energy and grains more than offsetting gains in the other sectors, especially industrial metals and softs. The dollar was weaker against all of its major counterparts, especially the JPY and AUD, but this failed to have any major positive impact on commodities, perhaps apart from gold which managed to recover from another bout of selling.



Crude oil lower but support not far away

The main driver behind the rally in WTI crude oil during July was the unexpected large increase in demand from refineries which were gearing up after maintenance in order to satisfy motorists' demand for gasoline during the summer driving season. As a result, we saw national levels of crude inventories drop sharply during July, not least at Cushing, the delivery hub for WTI crude oil trading in New York.

The latest weekly inventory data from the US, however, surprised the market in the sense that national motor gasoline inventories rose instead of dropping as expected. In fact, the increase of 135,000 barrels to 223.6 million resulted in the highest level of inventory for this time of year since at least 1990. In other words, it looks as if demand is failing to keep up with supply just as we approach the final weeks of the US driving season which normally ends around Labour day in early September. As a result, the price of RBOB gasoline traded in New York has seen a sharp retracement from its July peak and ended up being one of the worst performing commodities this week at one stage loosing more than six percent.

OPEC production slowing

WTI crude dropped to its lowest level in a month before better-than-expected Chinese industrial production number together with continued focus on supply disruptions in Libya helped stabilise prices. Worsening labour disputes in Libya combined with faltering supply from Iraq resulted in OPEC output dropping to its lowest level in six month during July, according to the International Energy Agency. Saudi Arabia produced the most in a year in order to meet a seasonal increase in domestic demand with crude oil being used by power generators during the peak season for electricity demand.

With growth expectations rising or at least showing a stable outlook in China, the USA and Europe, slowing supply from OPEC, especially from countries like Libya, Nigeria and Iraq will continue to keep oil prices supported into September. After this, seasonal demand from refineries across the northern hemisphere should drop and leave the price more exposed to the downside. According to OPEC data, the production level from Libya, Nigeria and Iraq are down by almost 900,000 barrels compared with a year ago. Most of the losses stem from the situation in Libya where strikes and social unrest have triggered a sharp reduction over the past few months. Although the Libyan reduction has been the largest, a return to normality is expected, but the production slowdown in Iraq is more of a concern in the medium term as no quick fix exists to mend sectarian violence and poor infrastructure.

Brent crude oil has since April been stuck in a rising channel currently between 110.50 and 102 dollar per barrel with the upper half of this range seeing most of the action since July. This trading pattern with the added support/risk of additional supply disruptions is expected to continue for at least another month until the expected seasonal slowdown in demand begins.

Industrial metals takes the lead

The price developments of key metals such as copper and iron ore used in steel production are still much dependent of the level of demand coming from China, the world's biggest consumer. This was clearly seen this week when July data showed that iron ore imports rose to a new record while copper imports increased by 12 percent compared with a year ago. Copper rallied strongly as a result and in the process broke out of its recent range. Speculative traders such as hedge funds have maintained a net-short position in High Grade Copper since February and some short covering would have been seen during this week. Using copper as way of obtaining finance continues to be popular in China and until we see fresh signs of copper actually being consumed and not just put away for financing purposes, further upside potentials beyond 340 cents per pound on High Grade Copper seem limited.

Silver supported by the rally in industrial metals
The rally seen across industrial metals also lent some support to silver given its industrial credentials. As a result, it managed to outperform gold with the price of one ounce of gold falling from a three-year peak at 67 silver ounces to 64.6. Gold, which earlier had run into renewed selling below 1,300 dollars per ounce, found support towards 1,264 before a weaker dollar and stronger silver saw buyers return taking it back to relative safety above the mentioned 1,300 level.

Precious metals are still focusing on raised growth expectations, low inflation and early tapering of US quantitative easing and this will continue to dampen any recovery hopes. Gold needs to make a decisive break back above 1,350 before additional buying can be seen and until then the most likely outcome is continued range bound trading between 1,245 and 1,350.

Government intervention supporting Arabica coffee
High quality Arabica coffee, which recently dropped to the lowest level in four years, has since managed to recover and it is currently one of the top performing commodities. Whether this is a case of "low prices cure low prices" remains to be seen but news from Brazil that roasters are beginning to increase

Brazil is the world’s largest producer of the quality beans and has been losing out to the cheaper and lower quality Robusta bean in recent years. But the drop in the spread between the two beans from 190 cents in 2011 to 31 cents last week may provide the incentive to increase the portion of Arabica in blends thereby assisting demand.

Most important, however, is the long-awaited initiative by the Brazilian government to support prices. In an effort to prop up prices it announced an intention to buy as many as three million 60 kilogram bags at USD 149, well above the current market price of around 123 dollars. The move has been in response to calls from farmers who are currently selling their crops below cost. Although this intervention will remove bags from the market, the outlook which points towards a record crop both in 2013 and 2014 will if anything probably only help to stabilise prices not trigger a change in direction.

Key crops stuck in negative momentum with bumper crop lurking
The summer across the northern hemisphere has so far, in contrast to the previous two years, been providing near perfect growing conditions for key crops such as corn, wheat and soybeans. This has resulted in negative price momentum building over the past few months, much in contrast to the dramatic drought last summer especially in the US but also around the Black Sea region which resulted in record high prices and low inventories.

As a result of this continued weakness in agriculture prices we have seen increased selling pressure by hedge funds and recent data shows they are now their most gloomy ever on the agriculture price prospects. As of Tuesday July 30, they held a combined net-short position of 88,397 contracts of futures and options exposure, a dramatic change from plus 211,000 contracts a month earlier.

The crop that has seen its price prospects deteriorate the most has been corn, resulting in hedge funds now holding a record short position of 108,089 contracts while soybeans still attracts a netlong position of 75,490 contracts. Taking a closer look at corn we see that the current price of this year's new crop is trading well below what we have seen for the same time in the previous two years. The December future has reached 460 cents per bushel which corresponds with the lowest new crop price since September 2010.

As long as we continue to see excellent prospects for this year's crop, producer and speculative selling will continue to keep prices under pressure. However one of the potential dangers which could lend some support, especially to corn, later on, could be the risk of early frost. The planting this spring was delayed in the US due to very wet weather conditions and this should also lead to a later harvest than usual which carries the outside risk of some frost damage.