

Metals up and oil down in a week where the FOMC surprised most

The key event this week was without a doubt the long-awaited US central bank meeting where the Federal Open Market Committee was generally expected to begin scaling back its massive asset purchase programme. Swayed by recent economic data, which had been weaker than expected, the Federal Reserve managed to wrong foot almost everyone by keeping its monthly asset purchases unchanged at USD 85 billion per month. The announcement triggered an immediate and dramatic increase in investors' risk appetite with stocks and bonds rallying while the US dollar was sold, thereby lifting the general investment outlook for commodities.

Growth-dependent commodities, especially industrial metals but also crude oil received a boost from this news and the resultant initial expectation that maintaining the wall of money in the system the economy will recover faster and thereby so too will demand. Precious metals however witnessed the biggest gains as negative sentiment and short selling ahead of the announcement caused a dramatic rally, not least lead by the drop in government bond yields and the weaker dollar.

By the end of this eventful week some of the excitement in commodities had already begun to wear off with the precious metals' advance slowing and crude oil going into reverse, not least driven by news about increased supply and reduced geo-political tensions. The agriculture sector did not feel much of an impact from the non-taper decision with focus more directed on product specific fundamentals, such as focus on the US harvest of key crops and ample supply of coffee from key growing nations such as Brazil, Columbia and Vietnam.



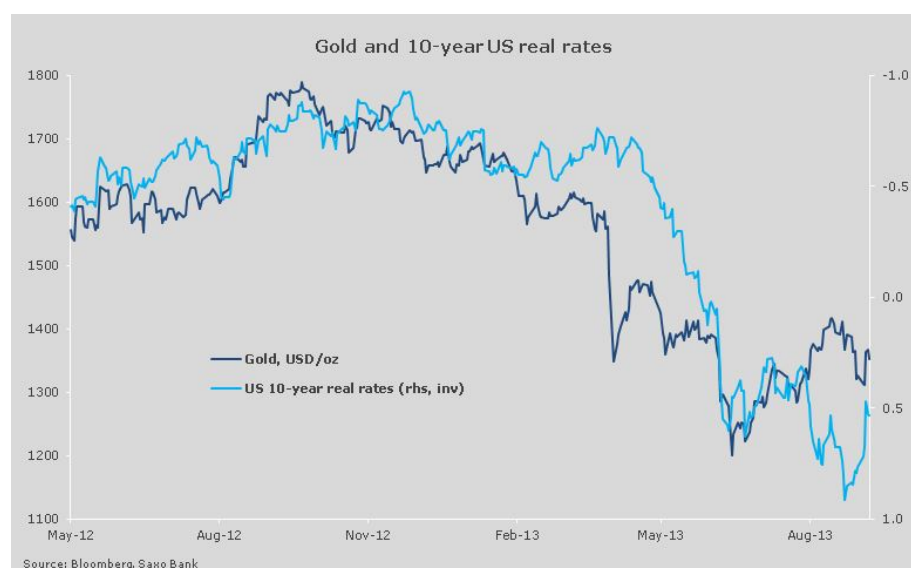
Relief rally in gold and silver but will it last?

From a position of weakness both metals jumped on the surprise news from the US Federal Reserve, not least helped by the biggest 10-year government bond rally in almost two years and a weaker dollar. The initial rally was most likely driven by short covering with hedge funds having been seen as sellers in the days leading up to the announcement. The amount of short futures positions held by hedge funds reached the lowest level in seven months during the week ending September 10. Furthermore, the renewed attempts by hedge funds to rebuild some of these short positions were firmly quashed and the question now remains whether the delayed tapering will be enough to support a continued rally from here.

This hinges very much on the strength or weakness of upcoming US economic data. This means the FOMC could delay its decision once, twice or potentially not act at all if the recent weakness in economic data continues. The near-term focus now switches to the US government where President Obama and Congress once again are fighting over the need to raise the US debt ceiling. If an agreement to raise the ceiling is not reached before October 1 then US government operations will grind to a halt and a debt default could follow some weeks later. During this time of uncertainty gold may, just as witnessed last year, become the asset of choice for many, thereby lending support.

Lower US real yields

US real yields have moved lower, especially since yesterday, bringing them more in line with the current gold price as seen on the chart below. As we move towards December, tapering talk will re-emerge, unless economic data continues to deteriorate and this should once again lead to some price pressure into the new year. For now though the most likely range over the coming month looks like USD 1,275/ounce to USD 1,488/ounce which if reached would represent a 50 percent retracement of the October 2012 to June 28 sell-off.



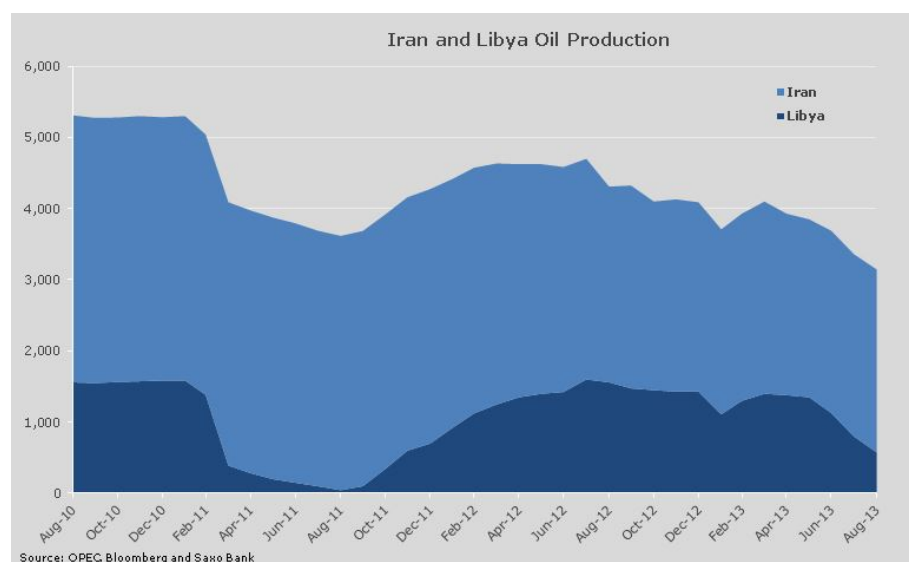
Source: Bloomberg and Saxo Bank

Negative investment flows out of Exchange Traded Products, both before and more importantly after the Fed announcement, represent a somewhat worrying sign, especially for the those looking for the rally to continue. During the past week investment flows have been negative by 18 tonnes. This indicates the continuation of subdued interest for gold ETPs during the past couple of months, despite the price recovering from the June lows. The attitude of institutional investors towards gold as an asset class is key as investment demand is needed to support the already known demand from the physical gold market.

Crude oil loosing momentum with supply returning

Both Brent and WTI Crude oil futures were lower for a second week as Syrian tensions continued to ease, together with news that Libya had begun to restart some of its production following a month-long period marred by strikes and disruptions. The prospect of returning supply at a time of a seasonal slowdown in demand ensured that the risk-on rally following the FOMC announcement ended up being short-lived.

Market speculation concerning the situation in Iran has increased due to several media reports that Iran has offered to shut down its Fordo uranium enrichment facility in exchange for an easing of international sanctions. A meeting could take place at the UN in New York next week between President Obama and President Rouhani. This would be the first meeting between leaders from the two countries since the 1979 revolution in Iran.



Source: OPEC, Bloomberg and Saxo Bank

Oil production from Iran and Libya give an indication of what impact a solution to these two issues would have on global supply. From a recent combined peak production level of 4.7 million barrels per day last July, the combination of Iranian sanctions and the Libyan strike has seen the countries' combined production drop by 1.6 million barrels per day to 3.1 million bpd last month. During the same time, total US oil production has increased by 1.4 million bpd, which together with increased Saudi Arabian production goes a long way to explaining why oil prices have remained relatively stable during this time of disruptions.

Just how much has the US oil market changed?

Just how fast and by how much the US oil market has changed in a relatively short period of time was highlighted by the American Petroleum Institute which reported the following observations related to the month of August compared with a year ago:

- US oil production increased by 20 percent to 7.59 million barrels per day (mbpd) to a 25-year high
- Total fuel and crude oil imports were down by 10 percent to 9.8 mbpd, an 18-year low for August
- Fuel exports rose 16 percent to 3.5 mbpd, the highest ever

This also helps to explain why the current reduction in US crude oil inventories has not translated into higher prices. It is a result of increased refinery output going towards exports combined with reduced imports. As a result it leaves a greater amount of both crude oil and products available for the global market which helps maintain a healthy balance between supply and demand.

Rising supply

It is still very early days to be speculating about the return of Iranian oil but if the momentum towards dialogue continues then the world could see a near-term future where supplies rise faster than demand. This will begin to apply downside pressure to prices, once global inventories have been rebuilt following the supply outages this summer.

Saudi Arabia favors an oil price of around USD 100/barrel and if approached it may begin to reduce its production from current record levels. Such a decrease in production will raise the kingdom's level of spare capacity, thereby further reducing the future risk of price spikes.

