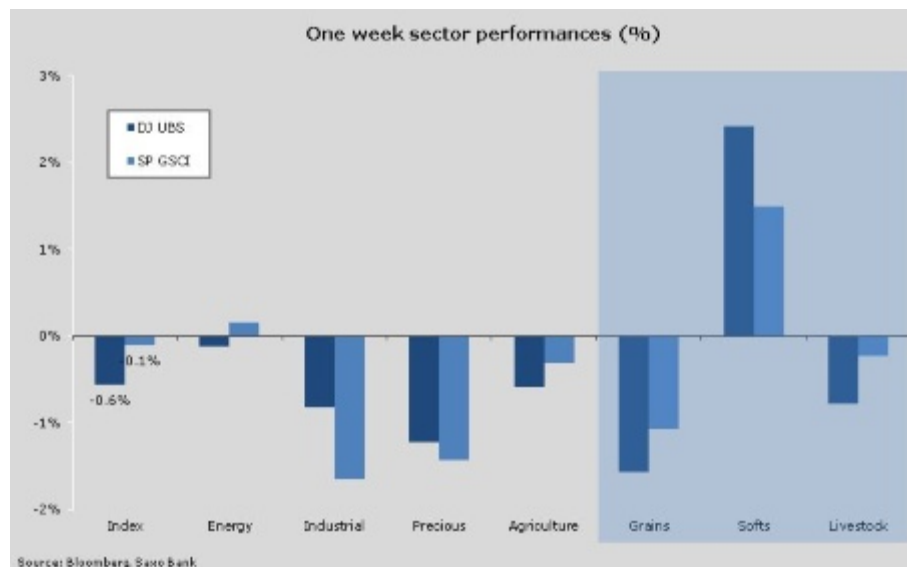


US shutdown spooks commodities at a time of rising supply

From Ole Hansen, Head of Commodity Strategy, Saxo Bank

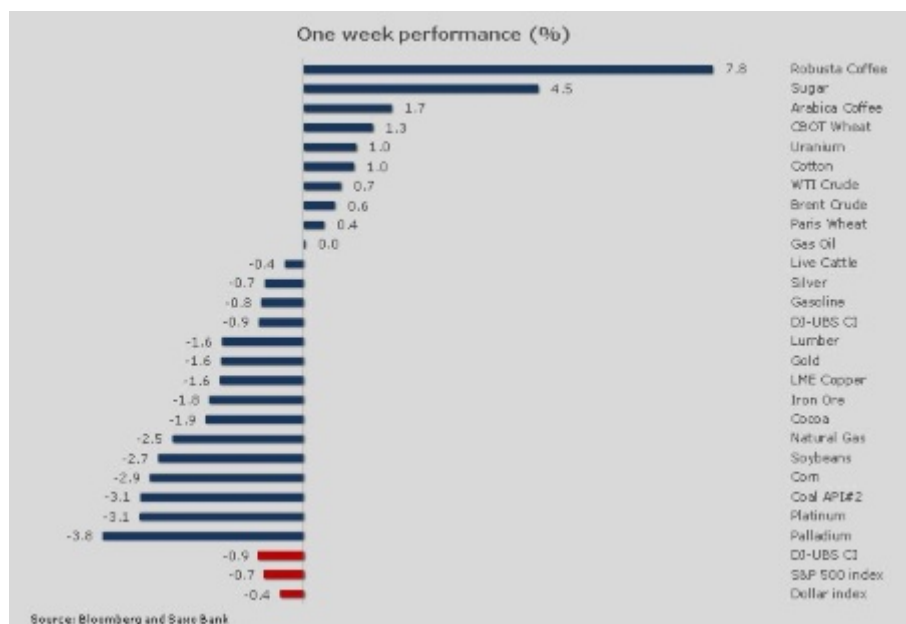
The ongoing risk to the US and possibly also the global economy from the US government shutdown and wrangling over the debt limit has caused a great deal of nervous trading in commodities. A potential economic slowdown at a time where supplies have begun to recover among many key commodities triggered price weakness across most sectors. The declines were mostly felt in the metals sector - mainly industrial metals but somewhat surprisingly also in precious metals. Meanwhile, the energy sector did reasonably well as supply tightness, following several months of supply disruptions, kept the price of both crude oils (WTI and Brent) supported. What the market needs and cannot get at the moment is US economic data to guide future expectations and with such information, including the all-important US employment report for September, currently lacking the focus remains firmly on Capitol Hill in Washington.



Source: Bloomberg and Saxo Bank

Dow Jones UBS drops for fourth consecutive week

The Dow Jones UBS Index was down for the fourth week in a row as it failed to find any support from US dollar weakness witnessed during this period. As the table above shows, all sectors apart from Softs were sold. Concerning individual performances in soft commodities, sugar, coffee and cotton were among the top performers while corn and soybeans were among the worst performers as a bumper US crop is fast becoming a reality.



Platinum and palladium drag precious metals lower

The precious metals sector was primarily pulled down by platinum and palladium as worries about an economic slowdown triggered some long liquidation from hedge funds holding elevated net-long positions.

At the beginning of the week a great deal of volatility was seen in both gold and silver, after both succumbed to a violent phase of long liquidation before recovering fairly swiftly. During a 24-hour period, silver and gold dropped by six percent and 4.5 percent respectively, before recovering. The sell-off caught many off guard, which also helps to explain the speed at which the two precious metals sold. The reason why this surprised was the fact that the developments in the US could potentially result in quantitative easing being extended instead of scaled back, thereby renewing support for gold.

The London Bullion Metal Association (LBMA) held its annual conference during the day of the sell-off and with 700 delegates attending many trading desks was left thinly staffed with long positions left to be protected by sell-stops. Once the news about the shutdown was announced and gold failed to rally disappointment set in. Furthermore, once the first line of support at USD 1,320/ounce was broken sell orders accumulated to the extent that 1,290 was met before supporting buy orders halted the move.

The sharp sell-off last Tuesday and subsequent firm rejection at USD 1,277/ounce, which is and was key support, helped settle a few nerves. Looking ahead we are still in an overall >downtrend from late August, however the ongoing risk to the global economy from the US government shutdown and wrangling over the debt limit should provide enough support for an eventual retest of trend-line resistance at 1336, while support is firmly established at the USD 1,277/ounce level. On that basis we have a constructive view for the week ahead on gold as long as it holds above USD 1,295/ounce. If however there is a solution during the coming days the price may drop as safe haven positions will be closed. This uncertainty will ensure another week of nervous trading.

Spot gold



Source: Saxo Bank

Silver and gold supported near term by US shutdown

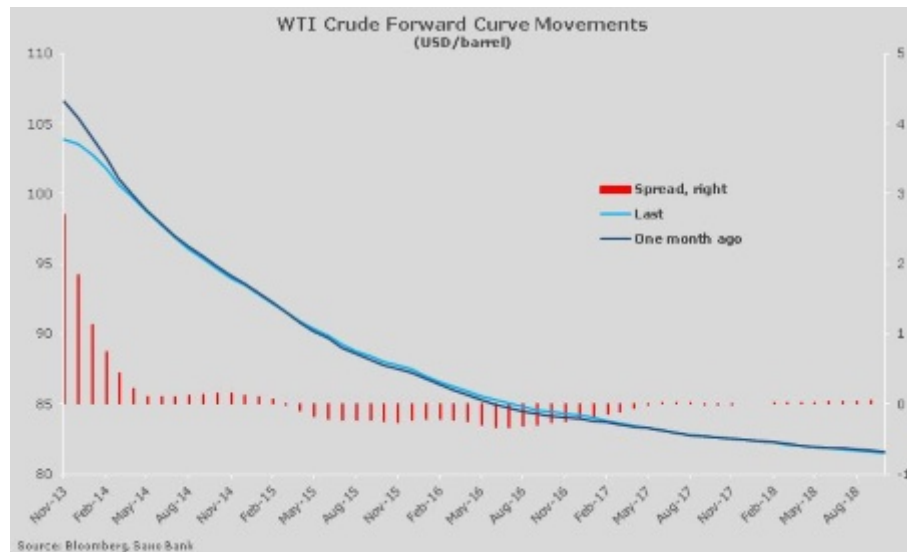
Apart from last Tuesday's sell-off, silver has been stuck around USD 21.70/ounce for the past two weeks. The downtrend from late August provides resistance at USD 22.25/ounce while support was found below USD 20.85/ounce. Just like gold, the trend and momentum points towards lower prices in silver but near term the US situation should provide support unless a solution is found.

Brent and WTI crude oil in positive territory

Both Brent and WTI Crude oil managed to stay in positive territory for the week despite worries about an economic slowdown in the US and the potential for it to spread further to emerging market (EM) economies, where most of the growth in demand stems from. US inventories rose as refineries, in line with expectations, began reducing their demand due to seasonality. News that TransCanada's southern Keystone XL pipeline extension from Cushing, Oklahoma to Nederland, Texas will start transporting crude before the end of the year helped further reduce WTI crude's discount to Brent crude. This increased flow away from the Midwest production region will further help to reduce the glut in this area, which for the past couple of years led to a disconnection between the prices of the two crude oils.

Other news from the oil market included an interesting analysis from the [Wall Street Journal](#) which concluded that the United States may overtake Russia as the world's largest producer of oil and gas in 2013. In just a few years the production gap between US and Russian oil production has narrowed by 3 million barrels with both countries now producing more than 10 million barrels per day of oil and related fuels. The dramatic increase in the US however comes at a very high cost of production leaving many exploration companies in the hands of their creditors who require proof of forward hedging in

order to supply the funding needed. So for this trend of increased production to continue, oil prices, both spot and more importantly deferred needs to remain high for the economics to make sense. The price of WTI crude for delivery in June 2015 and beyond are already priced below USD 90/barrel and with break-even costs remaining high a further drop in oil prices could trigger a reduction in supply from these new production techniques.



Source: Bloomberg and Saxo Bank

Warmer Iran-US relations bode well for oil supply

The relations between Iran and the US have warmed following the first direct contact between the presidents of the two countries since the 1979 Islamic revolution. This could eventually lead to some of the sanctions introduced in early 2012 being lifted, thereby making it easier for Iran to export oil. At this stage however, it is still too early to say whether these attempts will actually succeed. Iran is still holding on to its fundamental right to enrich uranium, which remains the key obstacle. Should Iran eventually be able to increase its exports this could lead to a short-term flooding of oil into the market with millions of barrels currently sitting in storage facilities and on Iranian controlled super tankers.

Oil prices supported by US situation

Near term, global oil prices remain supported despite the risk to demand from the US political shenanigans. Supplies were disrupted during the past few months, not least due to strikes in Libya and infrastructure issues in Iraq. Oil has begun to flow but it will take some time before inventory levels are rebuilt. This situation continues to support the backwardation seen in both Brent and WTI crude oil (as shown above), a situation that occurs when the price of oil for prompt delivery is higher than the deferred delivery price.

Until inventories reach satisfactory levels, both crude oils remain range bound with the upside limited as the risk to global growth persists. We see WTI Crude oil for prompt delivery staying within a USD 101-105/barrel range while for Brent Crude the range looks like USD 107-111/barrel.