

Commodities weaken on emerging-market turmoil, dollar strength

Commodity Weekly by Ole Hansen, Saxo Bank A/S

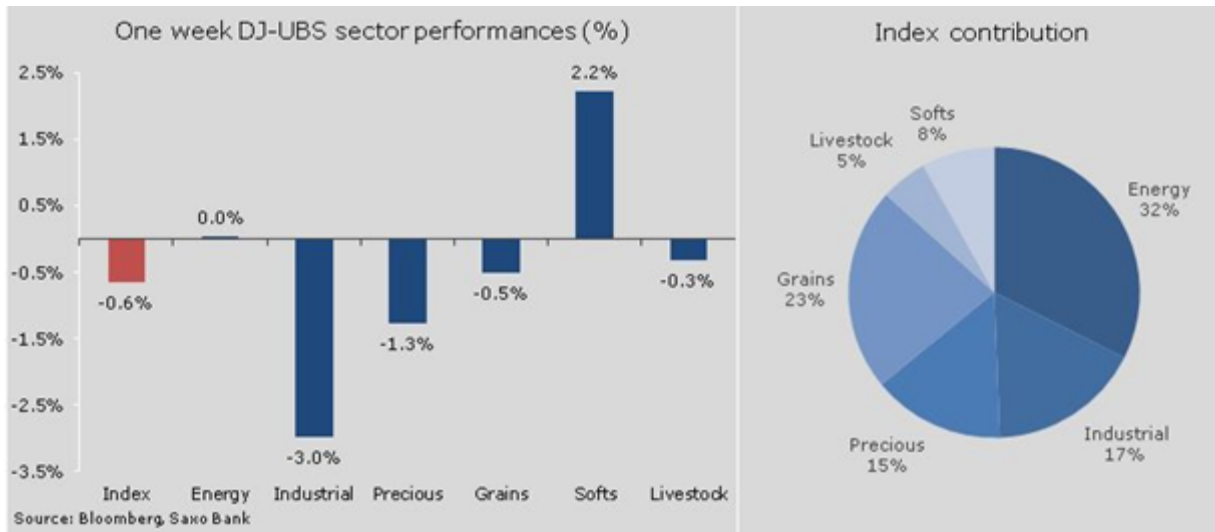
Commodities moved lower during the course of the week as the diverging outlook between emerging and developed economies continued to raise uncertainty about the demand outlook for commodities. The weakness was primarily driven by losses in both metal sectors with industrial metals being hurt by weak China manufacturing data together with a slowdown in activity ahead of the Lunar New Year shutdown in several Asian markets.

Precious metals failed to find support from the emerging-market turmoil and as result went looking for support. The energy sector was mostly driven by the near-term outlook for US weather which created some extreme volatility in natural gas and supported heating oil.



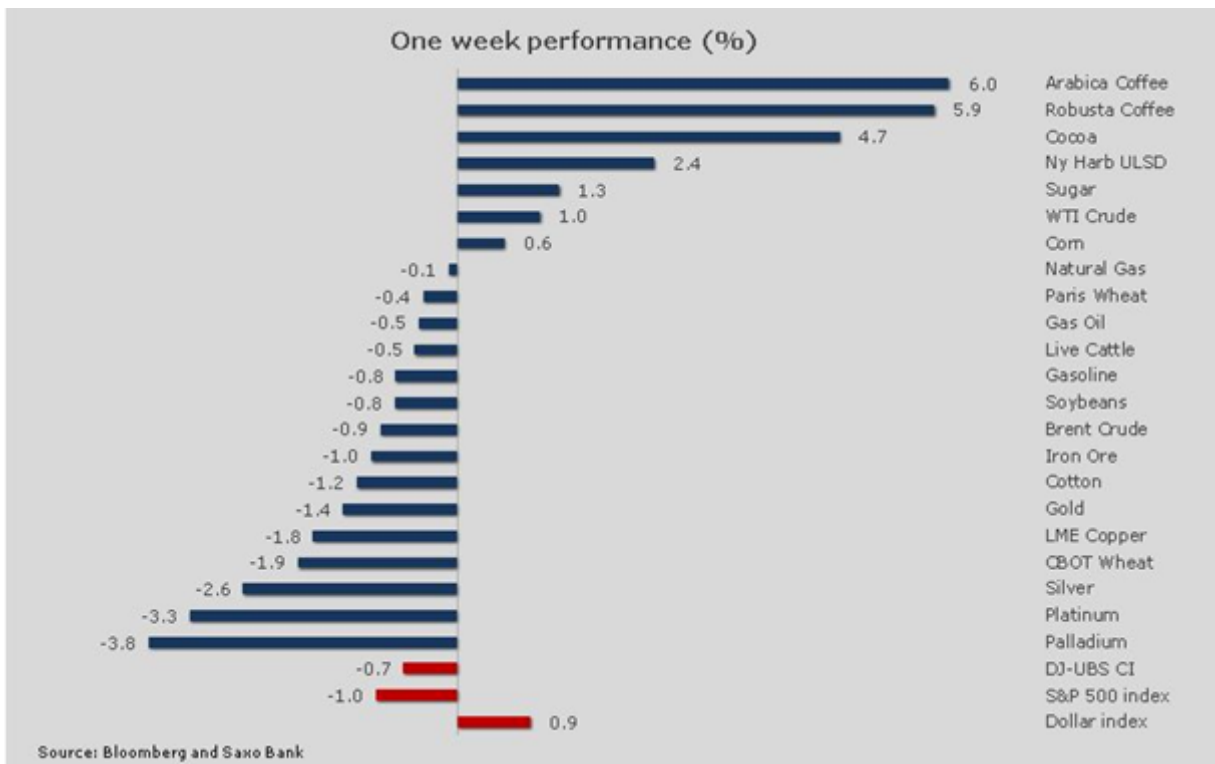
The prospect of another cold snap in America blanketing the likes of New York's Central Park has underpinned heating oil prices. Photo: John Anderson \ Thinkstock

The agriculture sector was mixed with continued weakness in key crops such as wheat while rising cocoa and coffee prices ensured a strong week for soft commodities.



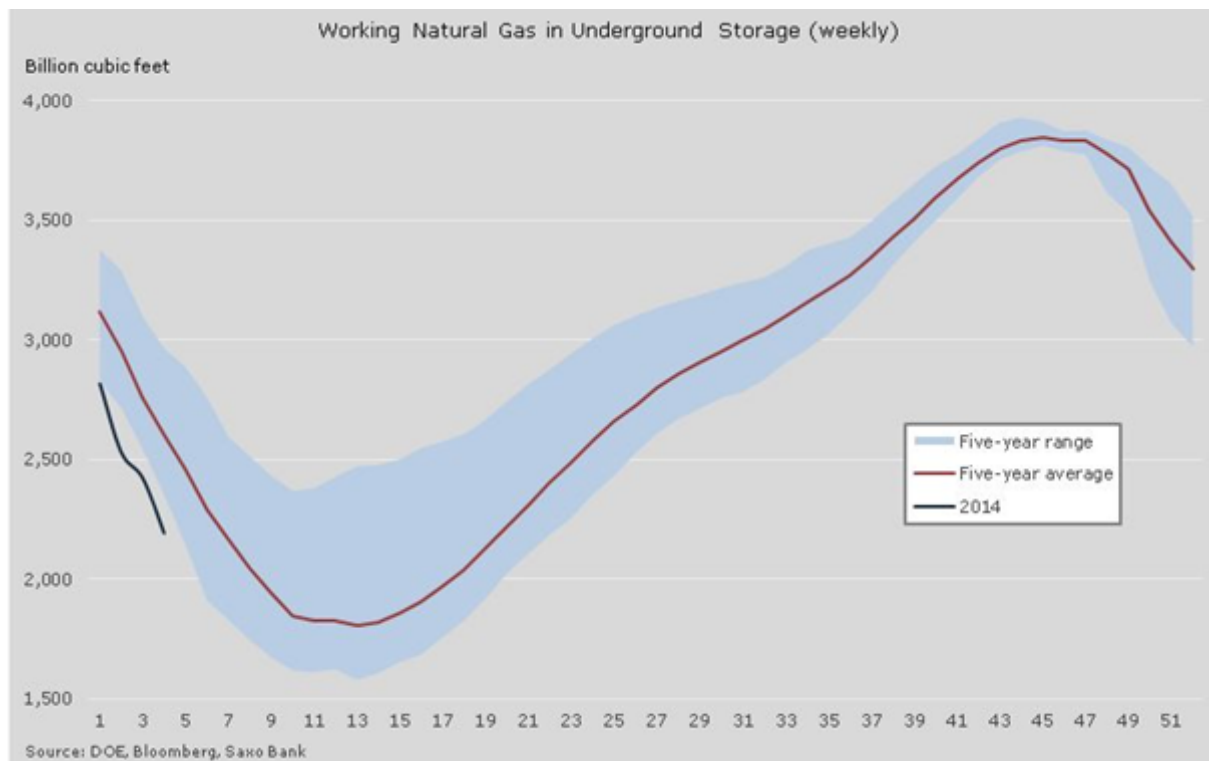
Coffee had the best weekly performance since December following two consecutive weeks of losses. Arabica coffee found support from above normal temperatures and dry weather in Brazil which has raised the risk of the upcoming crop being lower than current market forecasts. Robusta coffee found spill-over support from Arabica but also from reduced supplies from Vietnam and Indonesia. Vietnam is sitting on a very large coffee crop which could indicate the current strength may not continue with exports eventually expected to pick up.

The most active Cocoa contract for delivery in March rose the most since 2011 but stabilised after reaching USD 2,900 per ton. Increased demand from the three major regions of Europe, North America and Asia helped support the price while increased supply from the Ivory Coast may help stabilise the price, not least due to its current near overbought condition.



Crazy volatility in natural gas

After a steady climb for natural gas throughout the first half of January a return of extreme levels of volatility left many traders battered and bruised. A daily trading range of more than 12 percent was seen on three occasions this past week resulting in volatility spiking to almost 100 percent. The price reached USD 5.5 per therm two days in a row before quickly retracing below USD 5. The rally was driven by the speedy reduction in inventory levels which was triggered by rising demand at a time of weather-inflicted lower production. A forecast for milder weather into February resulted in a sharp reversal with the NGH4 contract seeing its biggest two day decline in more than four years.



Gold rangebound as Fed taper offset by EM turmoil

Gold returned to the lower end of its current range with the near-term outlook very much depending on the direction of the US stock market and the dollar. The positive pull from risk aversion related to the emerging-market turmoil gave support early on but solid US economic data and the ongoing tapering of the US Federal Reserves asset purchase program together with slowing Chinese demand sent the metal looking for support once again. The failure to gain a proper foothold above resistance at 1,272 USD /oz triggered another bailing out of long positions but with stock markets still not showing any signs of finding the gear that drove them higher last year, gold may find enough support from this weakness to stay above important support at 1,231 USD/ounce.

Despite the current rangebound nature, gold nevertheless had a good January which yielded a positive return for the first time since August and in the process, the yellow metal outperformed both bonds, stocks and the dollar. Compared with the beginning of the year, the investor attitude towards gold has been on the mend, but so far institutional investors continue to stay clear while hedge funds are only engaging on a relatively small scale. Continued stock market weakness and a prolonged emerging-market crisis may alter the outlook for global growth and eventually persuade investors back into gold, but until such time, a bearish approach by many investors will continue to limit the upside.

Strong dollar and falling stocks putting a brake on oil's further advance

WTI crude oil reached the highest level since early January as declining product inventories and the US winter lend support. Further upside beyond USD 99/barrel seems limited at this stage considering the impact the current turmoil may have on future demand and also considering the current strength of the dollar and stock market weakness. The discount to Brent crude moved below USD 10 for the first time since November as rising Libya production ensured increased availability of Opec oil while US demand was supported by the cold weather. As we approach February and March, further contraction of the spread could be hard to achieve as demand for crude oil from US Gulf Coast refineries may ease as the spring maintenance season kicks off.