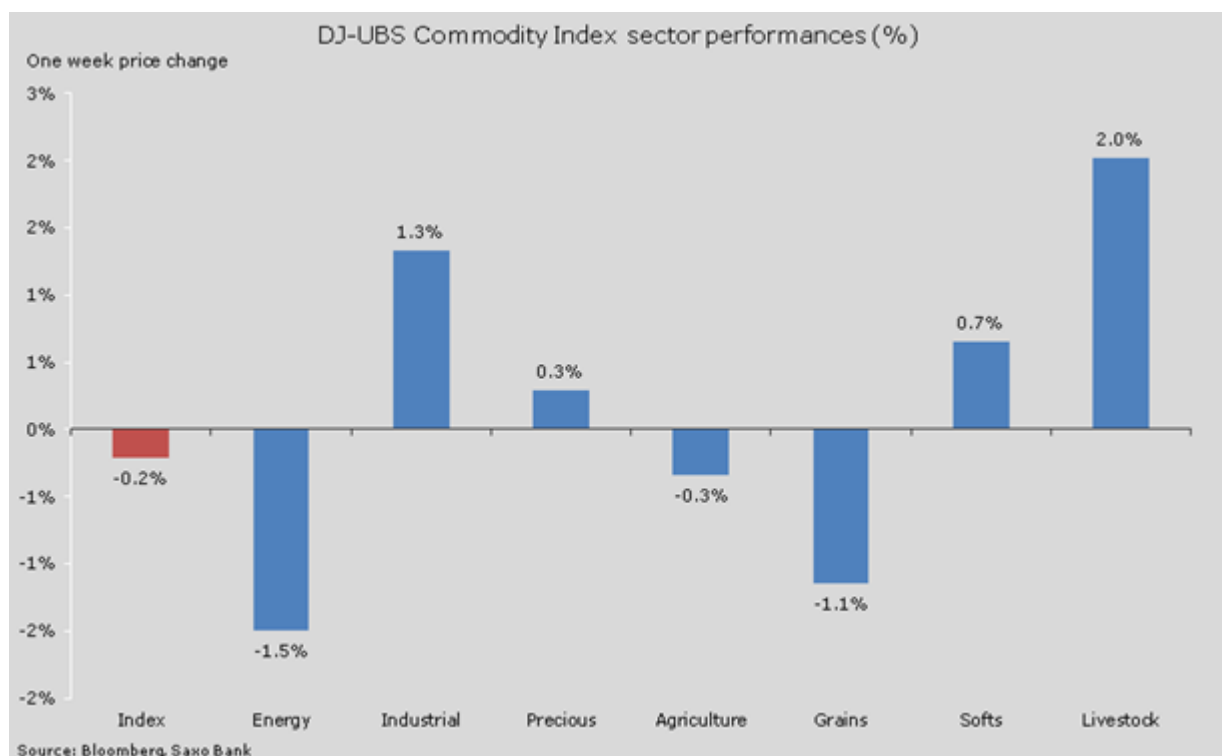


Crude oil retreats as Iraq keeps pumping and Libyan supply pick up

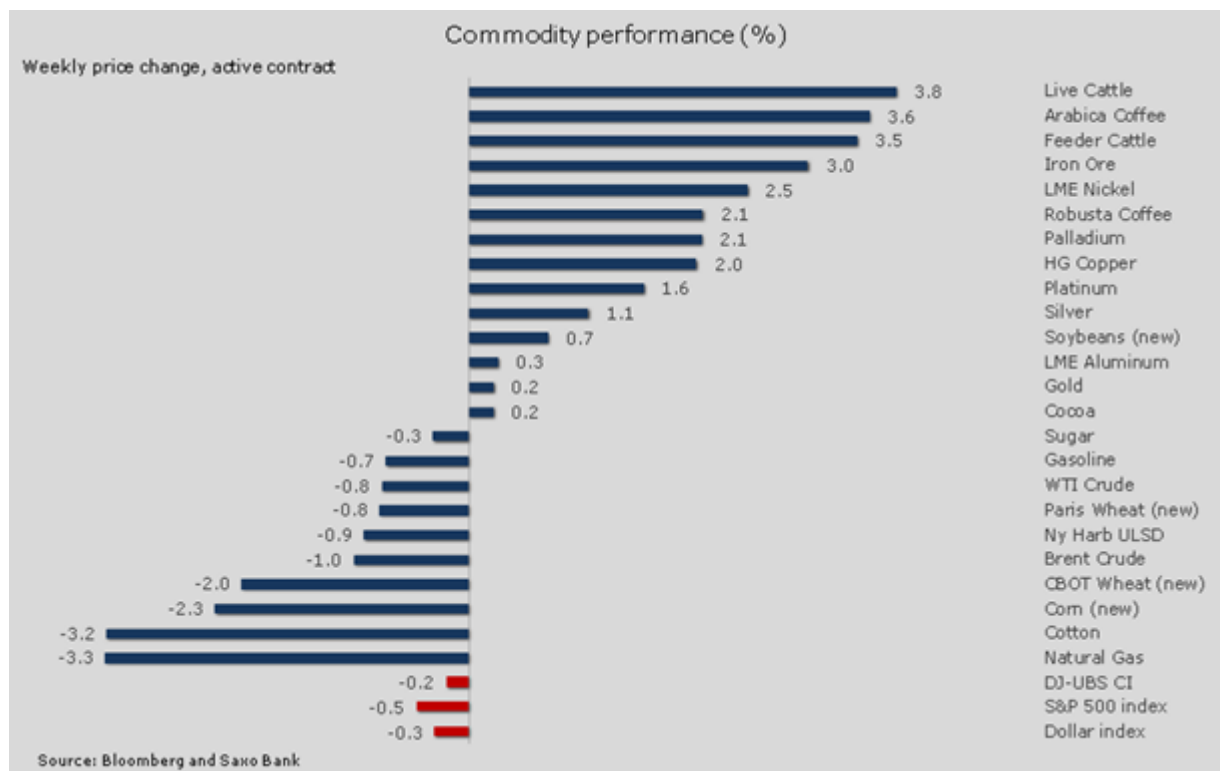
By Ole Hansen

- **Energy sector hit by selling as Iraqi oil keeps on flowing**
- **Outlook to bumper crop continues to weigh on corn and wheat**
- **Copper races ahead as stocks fall amid positive signals from China & US**

Commodity markets suffered their first, albeit small, weekly correction in a month with selling hitting the energy sector as oil supplies from Iraq continued to flow uninterrupted. Key crops such as corn and wheat remain under pressure mainly because of continued expectations of a bumper global crop. Industrial metals outperformed as copper rose to a 3½ month high with inventories falling and the US and Chinese economies continuing to show signs of recovery.



Livestock has become the strongest-performing sector in 2014 with reduced supply of cattle lifting the price of meat to a record. Meanwhile, the US motoring season beginning in early July will kick off with the highest prices at the pumps since 2008, making this season the most expensive from a barbecue and driving perspective for several years.



Precious metals managed to hold on to the gains from the previous week with silver reaching the highest since March thereby continuing to outperform gold which is now stuck in a 30 dollar range and looking for directional clues. News from China that its chief auditor had discovered USD 15 billion of loans backed by falsified gold transactions failed to trigger any reaction in the market but it once again highlights the ongoing worries about widespread fraud in Chinese commodities financing deals.

After one week of consolidation the recent rally in **oil markets** is now increasingly at risk of running out of steam. The crisis in Iraq has not gone away but so far key oil installations remain untouched. So instead of focusing on the risk of supply disruptions the market was presented with several pieces of news which could eventually lead to increased supply thereby leaving both Brent and WTI crude oil vulnerable to a correction.

Staying with Iraq, the oil minister was out saying that he expects that oil production will continue to rise over the coming months while the Kurdistan regional government in northern Iraq is looking to increase exports through a newly-built pipeline to Turkey from a current 200,000 barrels per day (bpd) towards 400,000 bpd by the end of the year.

Meanwhile in Libya crude oil production has risen to 300,000 bpd as production sites increase production and at the same time the eastern Hariga oil port has finally reopened. The waves of protests from state security guards, militias and tribesmen have resulted in Libya's production collapsing over the past year to the current low level from 1.6 million bpd back then. This has

been one of the main geopolitical worries during this period and one of the key reasons why Brent crude oil, the global benchmark, has been averaging 109 USD/barrel so far this year instead of 105 USD/barrel.

Finally, news from the US that two companies had received government permission allowing them to export an ultra-light variety known as condensate raised speculation that the government could be in the process of lifting a 40 year old ban on exporting crude. This turned out not to be the case but the decision will nevertheless increase US exports of refined products which is allowed.

Condensate primarily comes from shale oil production and after extraction it is heated to burn off certain gasses. This process, however light, has been enough to classify the product as refined and that means it qualifies for export. This will further add to global supplies and help reduce some of the bottlenecks in the US that has been created by the rapid rise in oil production to the highest since the 1970s primarily from shale formations.

WTI Crude oil remain supported but traders will be wary about a break back below 105 USD/oz as it may signal some additional weakness, initially down towards 102.70 USD/barrel followed by 101.60 USD/barrel.



Gold and **silver** managed to hold onto their recent gains but as the summer lull begins both metals are now trading water, especially gold where trading is now confined to a 1300 to 1330 USD/oz range. Silver has managed to consolidate its gains both outright but also relative to gold with the ratio having fallen to 62.5 (one ounce of gold measured in terms of ounces of silver), which is the lowest in four months.

Things to look out for has been the news from China that the authorities have found USD 15 billion of loans backed by falsified gold transactions and this has once again raised concerns about how real the demand from China actually is. The increased focus by the authorities may hurt future demand as they attempt to crack down on these types of lending arrangements where commodities are pledged as collateral for loans. The demand for physical gold from China and India is important as an offset against the reduced demand for paper gold investments through exchange traded funds and futures that we have seen during the past 18 months.

Bond yields have been moving lower and with future inflation expectations currently on the rise the yield offered to investors in US government bonds has been coming down during the past two weeks and this development has been adding some support to precious metals. Another source of support apart from crisis in Iraq has been the increased wariness about a potential correction in the US stock market. Bloomberg has reported that the demand for downside protection should the bull market falter has sent the price of bearish puts to a 15-year high relative to calls. A stock market correction could potentially send investors back into gold as they seek an alternative investment opportunity. Those holding bearish bets on gold are relying on continued speculation about when the US Federal Reserve will move from tapering to tightening to provide enough downside pressure on the price.



The price of gold remain stuck in a 1300 to 1330 USD/oz range with a break above signalling a move towards 1370 followed by the 2014 high at 1392 USD/oz. Below 1300 the 200-day moving average at 1285 will once again become the level to look out for in terms of providing support.

HG Copper has once again reached the top of its current range and is now facing resistance in the 3.19 to 3.215 USD/lb area following a ten-day rally. The price strength has been driven by improved economic data from China and US, the worlds two biggest consumers. Signs of increased demand can be seen through the availability of stock from warehouses monitored by the three major futures exchanges in London, Shanghai and New York. So far this year total inventories in these locations have fallen by more than 50 percent to reach their lowest level since 2008.

US natural gas futures remain range bound between 4.35 and 4.95 USD/MMBtu (million British thermal units) and following another bumper injection the price slid back towards the lower end of this range. US inventories ended the winter at precariously low levels following strong demand and the price has remain elevated in order to attract increase production and potentially a switch by power utilities back to coal. Producers seems to have picked up the challenge and we have now for the past ten weeks seen strong weekly injections into underground storage. It raises the chances that a comfortable inventory level can be reached before winter demand begins in early November. However, in order to reach a comfortable level of 3.5 trillion cubic feet in November, injections need to continue at a weekly average around 92 billion cubic feet compared with 72 bcf during this period last year. This leaves little room for error and as a result gas prices are expected to remain supported over the coming months.

