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WCU: Oil recovery capped as gold strikes back

Commodities were lower for the first week in four as losses in the agriculture sector, led by grains, more than offset gains made in energy. The dollar resumed its ascent rising by more than 3% as minutes from the latest Federal Open Market Committee meeting (surprisingly enough) left the door open for a June rate hike. This returned focus to the big central bank divergence currently being seen across the globe.

While the US is gearing up for a rate hike later in 2015, some 28 other global central banks – not least the European Central Bank – have all eased monetary conditions so far this year. As a result, the dollar resumed its ascent following a three-week pause and this helped create some additional headwind for commodities.

This was particularly obvious in grains, where US farmers already dealing with huge inventories are finding it increasingly difficult to compete for orders on the global market.



Short covering, ETP buying adds support in gold

Gold was one of the better performers, not least when measured in euros as it shrugged of the prospect of a potential earlier-than-expected rise in US interest rates.

Speculative short selling interest in gold futures recently reached a record high and following the failure to break below \$1180/oz some short covering has helped drive the metal back to \$1200/oz. This represents the middle of its current range between \$1175/oz and \$1225/oz.

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Holdings in exchange-traded products backed by physical gold were sharply reduced during March, but this week saw the largest daily increase in more than six weeks. This could indicate some renewed interest for bullion exposure following the discovery of support at \$1180/oz.



Source: Saxo Bank

Gold priced in euros rose to its highest level since January as investors continue to look for alternatives to European assets. The Eurozone, of course, has seen secure government bond yields trading at negative rates and stocks rally by more than 20% so far this year.

Opec oil production keep rising

A potential recovery in oil prices remains unsupported by Opec as the total March production – according to Bloomberg estimates – breached the 31 million barrel mark for the first time since August 2013.

With Iraq, Iran and Libya all raising production during a month where Saudi Arabia, according to its own data, produced a record 10.3 million barrels per day, the cartel's stated target of 30 million barrels has now been breached for the past 10 months in a row.

Doubts about how quickly a deal over Iran's nuclear programme can be solved provided some support to prices after Iranian supreme leader Ayatollah Ali Khamenei demanded that all sanctions on Iran should be lifted on the same day as any final agreement was reached. The US opposes this, with its position being that sanctions will only be removed gradually.

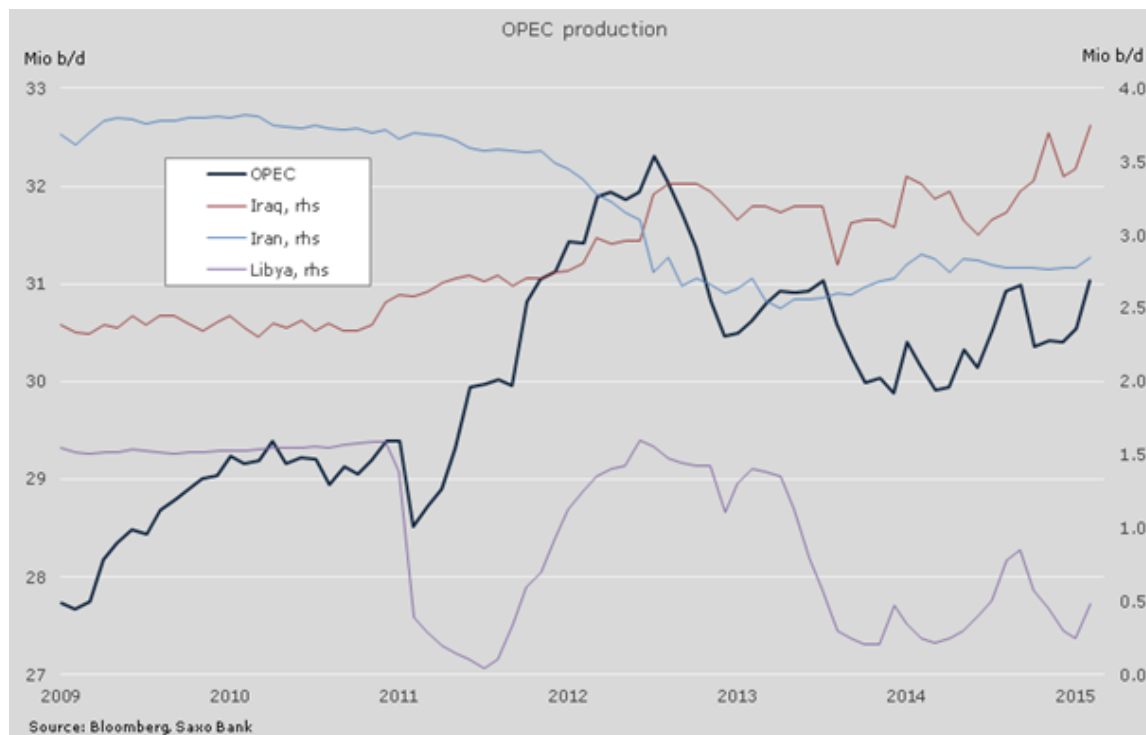
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US crude stockpiles up by 100 million barrels this year

Last week, US crude inventories jumped by the largest increment since 2001 as 10.9 million barrels were added to already ballooning stockpiles across the country. Since January, some 100 million barrels have been added to total inventories.

With production once again picking up after a drop the previous week, market participants are still left guessing about when a 50% reduction in rig count (since last October) will finally begin to have a negative impact on production.

The EIA and other major forecasters expects this turnaround only to be weeks away now, and once it kicks off we could see US production begin to slow from the current level of 9.4 million b/day towards 9 million by year-end.

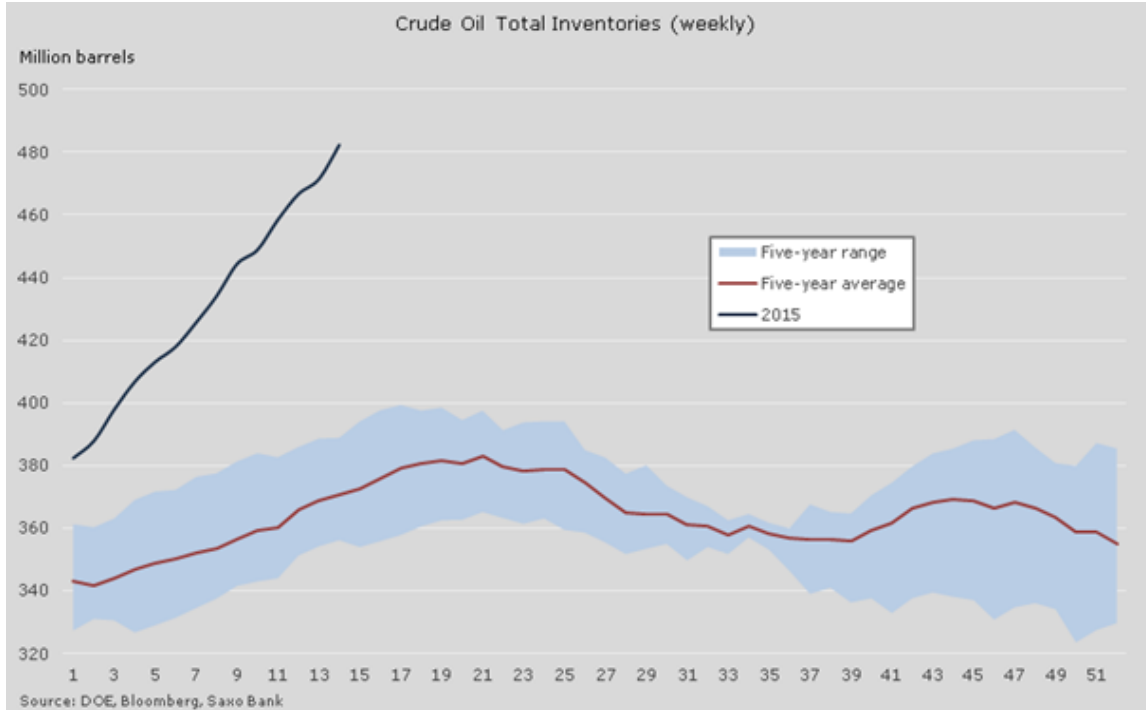
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WTI crude reached a one-month high above \$54/b (thereby completing a 22% rally since March 18) before the aforementioned headwinds triggered some renewed selling. For now, this leaves WTI crude stuck in a major trading range either side of \$50/b.

The pressure on spot crude from oversupply, especially in WTI crude, remains elevated with the prompt spread between the May future and the next widening to \$1.7/b representing a cost of 3.5% when rolling long positions.

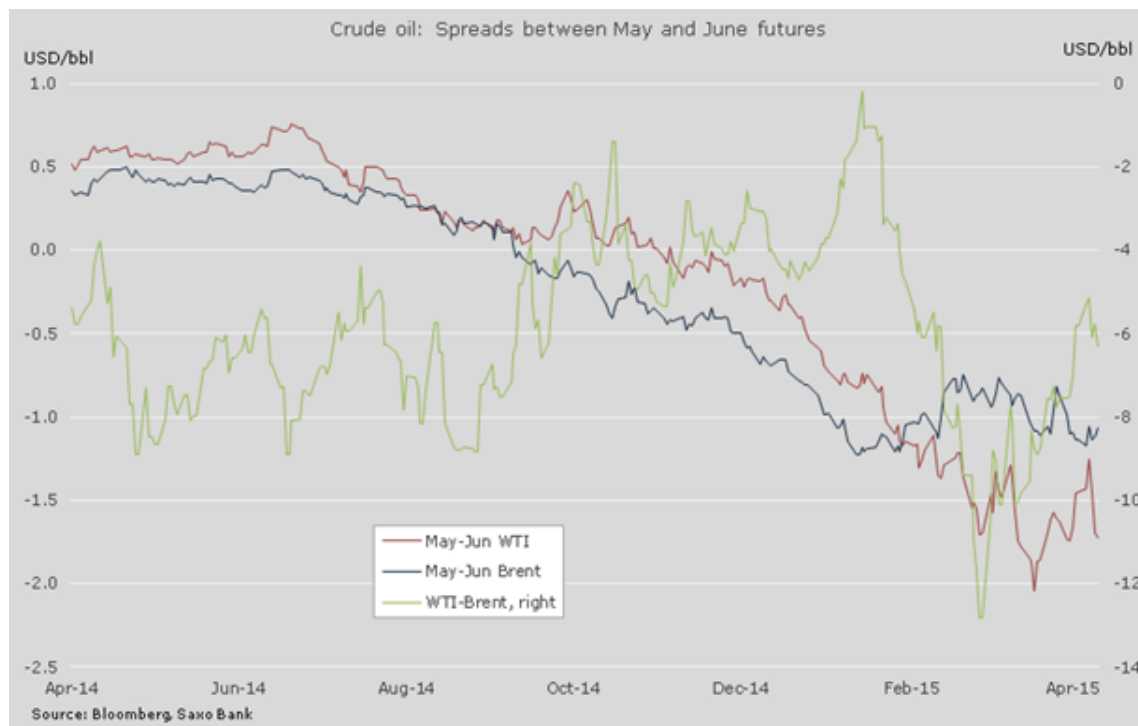
On the basis of US inventories remaining elevated for the foreseeable future, this should apply renewed downside pressure on WTI crude relative to Brent crude. The spread contracted to a two-month low at \$5/b this week, and from these levels it could easily expand outwards again.

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US natural gas hitting a 33 month low

The tender beginning of US LNG exports later this year can not come soon enough for US producers, who witnessed another horrid week in terms of price performance.

The cost of prompt month natural gas fell to just \$2.52/therm, a level that was last seen during the summer of 2012. Mild weather in the Eastern US led to another week of lower than expected consumption, which in turn led to a larger than expected jump in weekly inventories.

With producers from the various shale fields – not least Marcellus and Haynesville – continuing to produce record amounts of gas, the price has now fallen by almost half since last June and it is forecasted to drop even further over the coming months as the injection season kicks off in earnest.

The Sabine Pass LNG facility in Louisiana will ramp up production of exportable LNG later this year and as the chart below from Stratfor shows, several other facilities are currently under construction and will be ready to begin production starting in 2017.

Exports will, in other words, not help offset the current pace of production anytime soon and that leaves the price risk skewed to the downside for now.

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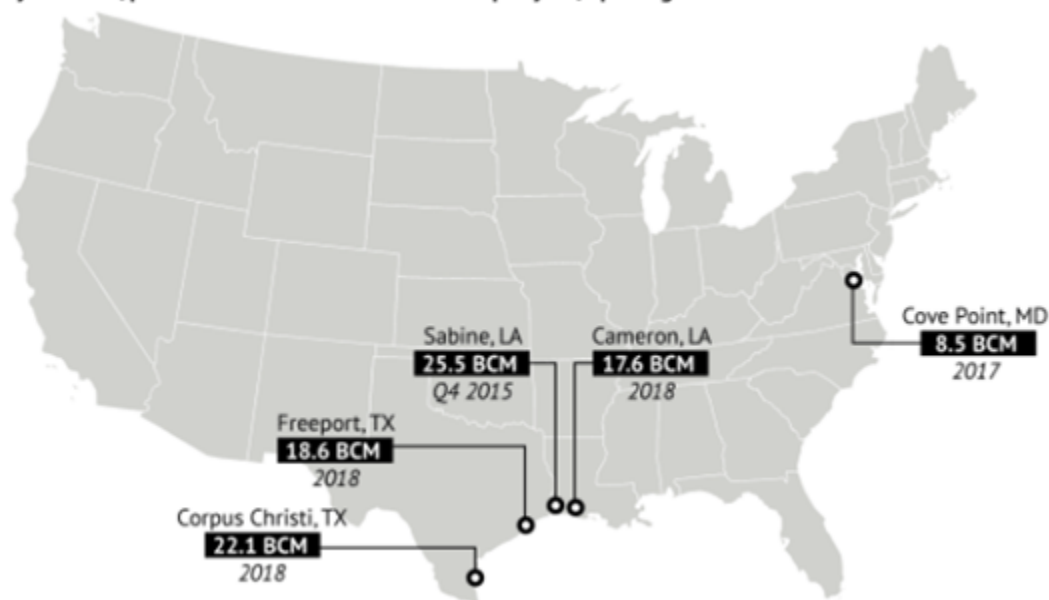
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Facility location, production in billion cubic meters per year, opening date:



Source: ferc.gov, Waterbourn Energy Inc.

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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income to commodities. He previously worked for 15 years in London, most recently for a multi-asset Futures and Forex Hedge fund, where he was in charge of the trade execution team. He is available for comments on most commodities, especially energies and precious metals.

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