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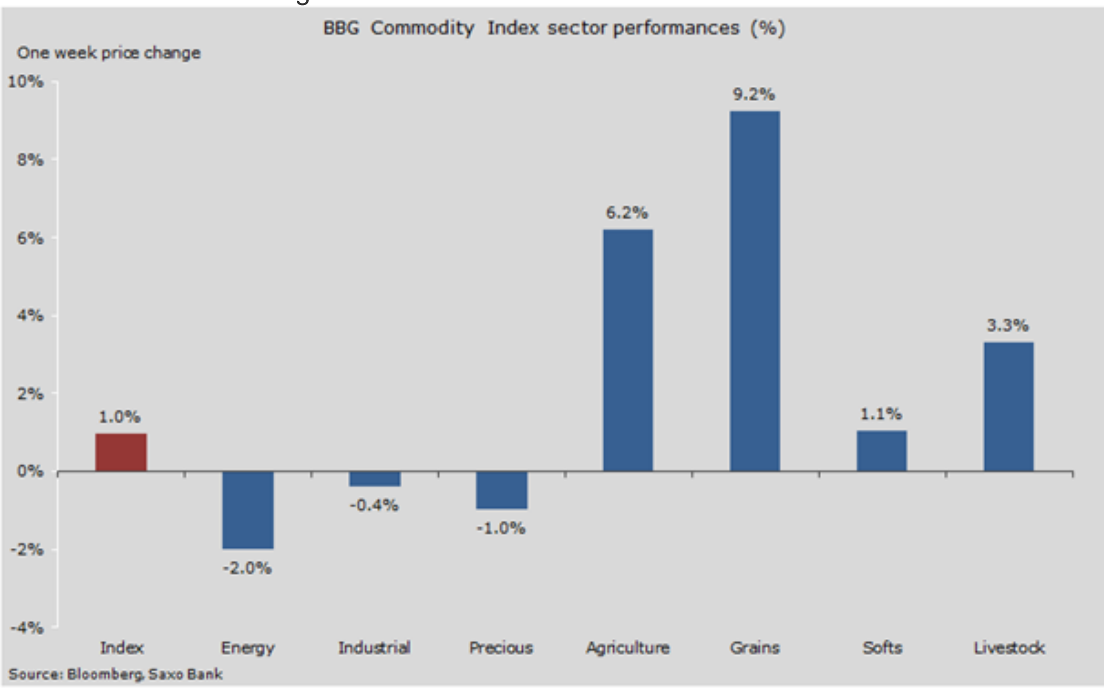
Weekly Commodity Update: Grains feel the heat while oil retreats

By Ole Hansen, head of commodity strategy at Saxo Bank (Twitter: @ole_s_hansen)

Commodities traded higher during this US holiday-shortened trading week. The gains, however, were far from broad-based as their lion's share was delivered by a few crops – such as corn and wheat –that were sent sharply higher as growing conditions across the world deteriorated.
The heavyweight energy sector was the worst performing as crude oil went into reverse on news about rising supply from Opec. But the US was also in focus as the long-awaited production slowdown has yet to be seen.
This past week even witnessed a surprise *rise* in inventories for the first time in nine weeks, while US drillers increased their rig count for the first time in 30 weeks.



Industrial metals were mixed, with copper finding a bid amid signs of improving US demand while nickel headed for its longest run of weekly losses since April as the Chinese equity bubble burst.
(This, of course, raised further concerns about the health of future demand from this the world's largest consumer.)
Iron ore was the biggest loser, helping drive the Aussie dollar down to a new six-year low. Following a second-quarter rally, the price of ore is plunging once again and analysts fear that it could get a lot worse.
Rising supply into a demand-challenged market has been triggered by major producers in Australia and Brazil fighting to maintain market share.

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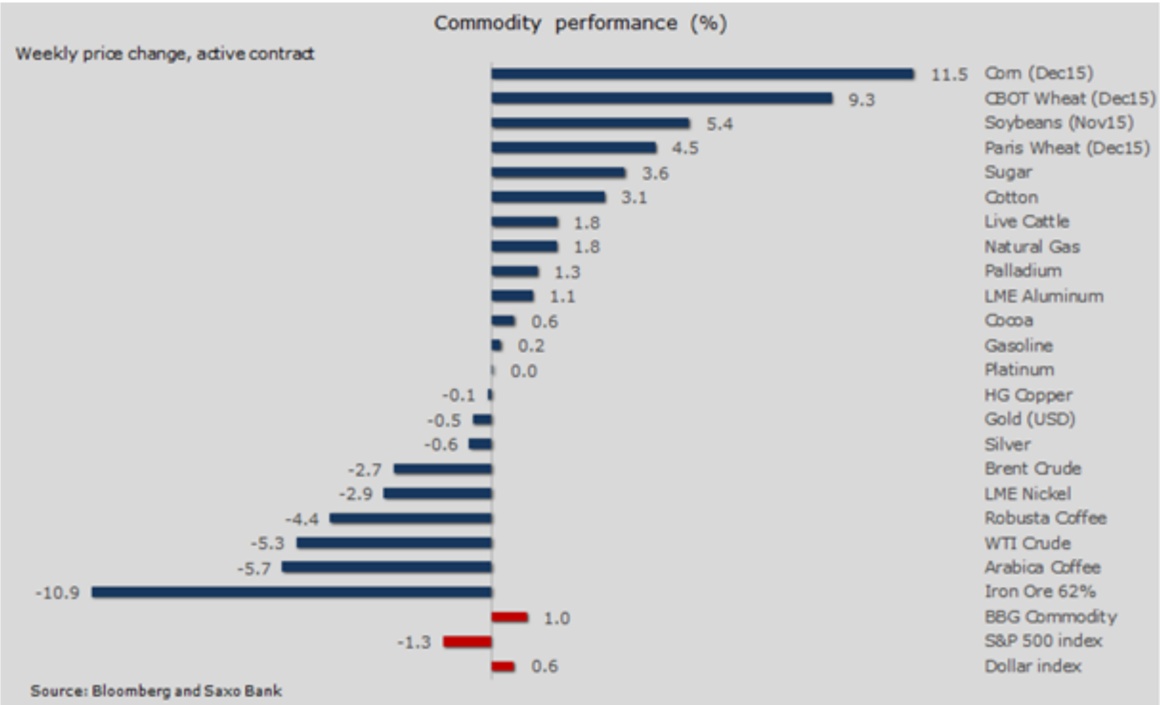


Soft NFP hands gold a lifeline

The yellow metal was on track to record a second weekly loss but after reaching a 15-week low at $1157/oz it managed to turn around and climb higher. The monthly job report from the US came out softer than expected and this could now potentially postpone the Federal Reserve's first US rate hike, which was widely expected to occur between September and December.

The unfolding crisis in Greece and the Sunday referendum have failed to boost the yellow metal despite raised volatility in both stocks and core bonds. This clearly shows that, apart from the limited appetite for gold currently seen among investors and traders, the anticipation of a Fed move continues to attract most of the interest.

As a result the price, will be continue to be exposed to the noise around US economic data releases just like we witnessed this past week.

We released our Q3 outlook this past week, and in it i wrote the following about gold: "We see the likelihood of the first rate hike in the US becoming a buying opportunity for gold as it removes the uncertainty that has seen many investors seek alternative investments during the past few years."

Emerging signs of inflation combined with raised uncertainty about the direction of stocks and core bonds – another perceived safe haven asset – could also persuade investors to have a rethink about gold.

Two major unknowns are still the direction of the dollar and when – and not if – the Chinese stock market bubble eventually bursts. A resumption of the dollar rally may create headwinds, while a correction in China may lend support.

We expect gold to maintain its sideways trading pattern until some of the drivers mentioned above come to fruition. During this time, gold may see another attempt to move to the downside.

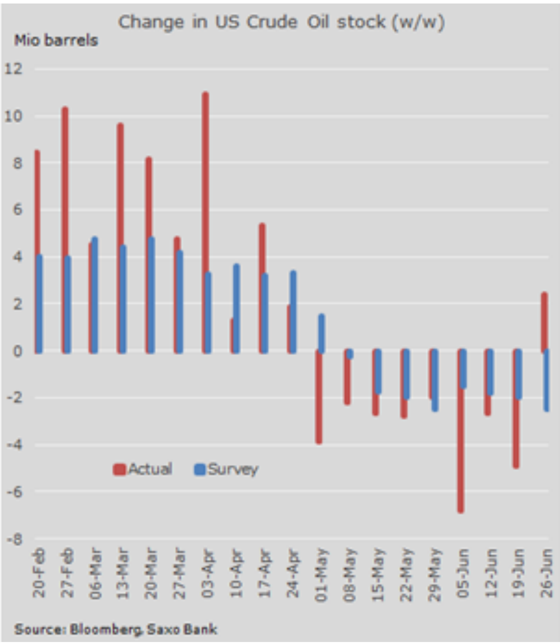
But with the low, in our view, being limited to $1,090/oz, we see an attempt to break the November 2014 low at $1,032/oz as a buying opportunity. We maintain our call for gold to finish the year at $1,275/oz, somewhat above current consensus.

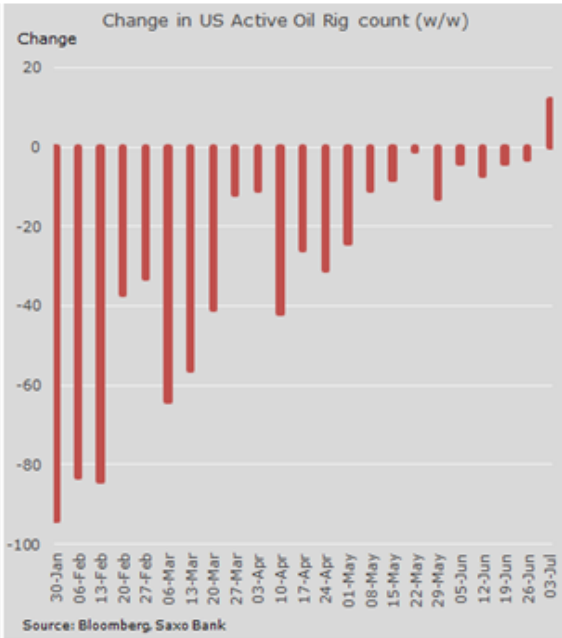
COMEX Gold future, first month cont.

Oil turns sour as US data erode support

The biggest provider of support for crude oil during the past quarter was abruptly removed this week when the US' stockpile of crude rose by 2.39 million barrels against expectations of a ninth consecutive drop.

US drillers put 12 rigs in the fields marking the first rise in 30 weeks following a 60% drop since last October – a drop that has so far failed to reduce US production, which is still running close to levels not seen since 1971.





In a week where the news flow from the oil market has generally been about increased supply, the reaction is now weighing heavily on prices. WTI Crude broke below previous support at $58/barrel thereby leaving behind the tight range around $60/b seen for the past months.

According to surveys, Opec has increased its June production to levels not seen since 2012 (courtesy of record production in Iraq and Saudi Arabia). Meanwhile in the US, the Energy Information Administration reported that April's production hit the highest level seen since 1971. Interestingly, Russia's June output approached a post-Soviet record as well.

The negotiation between Iran and a group of nations was extended for a week with the broad outlines of a mutually agreeable deal still there. Two unresolved issues, however, seem to be holding an agreement back for the time being: the pace at which sanctions are lifted and the specifics of the inspections regime.

In my Q3 outlook, I wrote this about oil: "Over the coming months and into next year, Opec is hoping that US production will continue to slow and that a continued rise in global demand will eventually allow the price to move higher as the risk of oversupply will fade despite the pickup in US production."

A continued bumpy ride for oil can therefore be expected. Given the risk of rising supply as refinery demand slows towards the end of the current quarter, the upside potential seems limited, thereby skewing the short-term risk to the downside.

During this quarter, we see Brent crude trading predominantly within a $55-70/b range and WTI crude within a $50-65b range with the downside risk most likely to be seen towards the end of this period.

WTI Crude oil, first futures month cont.

Grain outlook shift sees hedge funds run for cover

A massive rally was seen across key crops this past week with a deteriorating weather outlook in the US, Asia and Europe having supported what looks like a fundamental change in the outlook for crops this year.

From January to May 29, hedge funds and money managers changed their net exposure to corn, wheat and soybeans from a net-long of 305,000 lots to a record net-short of 328,000 lots. The pursuant rally had up until June 23 reduced these bearish bets to 145,000 lots, leaving a still sizable short position of which two-thirds belonged to corn.

The scramble to cover these short positions has been a major driver behind the rally, which may now begin to have run its course.

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The Bloomberg Grain index is up by 9.2% this past week with CBOT Corn spiking to a six-month high after the US Department of Agriculture lowered the total acreage US farmers are going to plant this year by 302,000 acres to 88.897 million
Stocks estimates as of June 1 also proved to be lower than expected.
The high at $4.40 from last December may just curb further advances for now.

CBOT Corn, December 2015 (new crop)

Source of all charts: Saxo Bank