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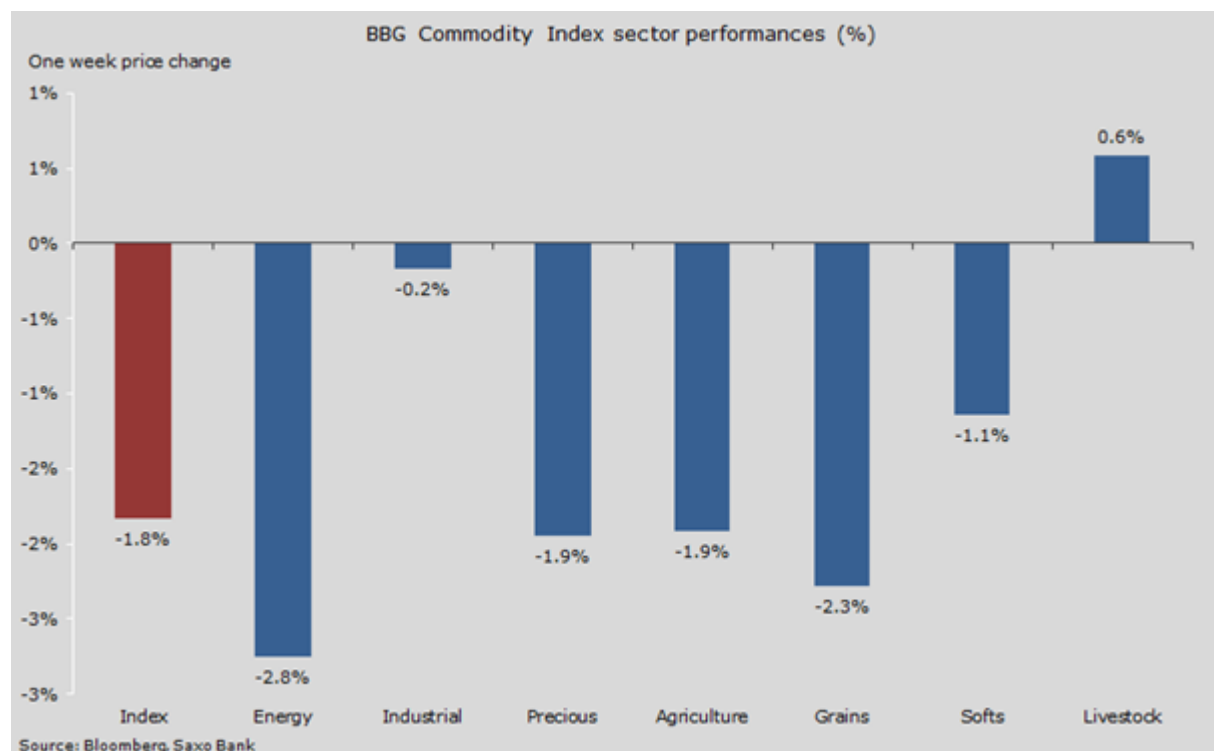
Weekly Commodity Update: Iranian deal rattles oil markets

By Ole Hansen, Head of Commodity Strategy at Saxo Bank (Twitter: @ole_s_hansen)

Commodities were lower for a second week as the dollar rose, the risk of Greek collapse faded and a nuclear deal with Iran was struck. The Chinese stock market stabilised and this helped support industrial metals while losses were seen elsewhere.

That was not least in crude oil which reacted negatively to the news that **a nuclear deal with Iran had finally been struck** as it opened another source of supply into an oversupplied market.

Adding to the pressure in oil markets was a surprise and counter-seasonal rise in US inventories at Cushing, Oklahoma, a key hub for WTI crude oil traders.



Only **livestock** was able to buck the trend this week with the index down 1.8%. Photo: iStock

Precious metals dropped for a fourth week as the dollar rose and the focus returned to the US where speculation about when interest rates will rise picked up once again. **With the chance of a Grexit fading** it was risk-on with stocks rising strongly while carry trades came back into fashion.

A carry trade is when traders seek to take advantage of the diverging interest outlook by selling euros against dollars and sterling. This focus helps to explain why the euro should suffer despite reduced uncertainty related to Greece.

Cocoa and Arabica coffee were a couple of exceptions in an otherwise negative week. Worries about growing conditions in Ghana, the world's second largest producer supported cocoa while signs of lower-

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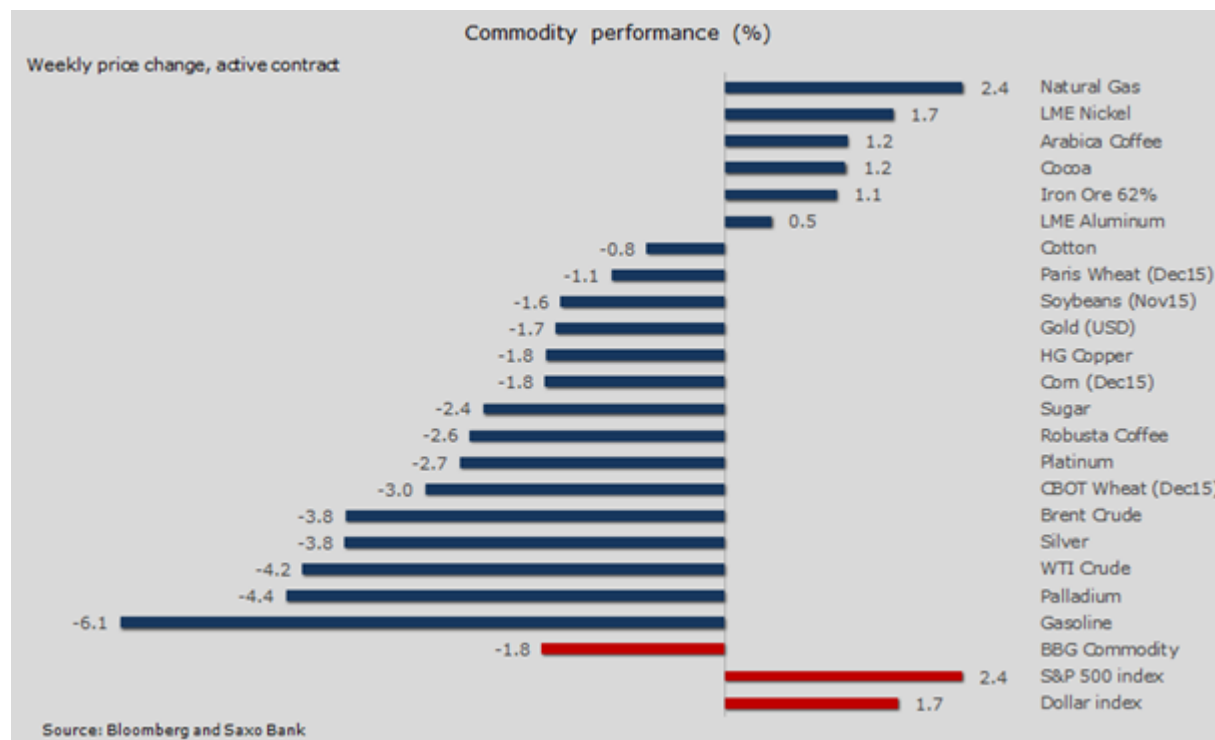
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than-expected output in Brazil gave coffee a lift although the downtrend where it has been stuck for most of the year remains intact.



There were more losers than winners last week, but **cocoa** and coffee some of the exceptions

The marathon negotiations between Iran and six powers came to a successful conclusion on Monday when finally an agreement was announced. This agreement, once ratified by the UN and respective governments should help to resolve a 12-year standoff over Iran's nuclear program.

Although heavily endorsed by President Barack Obama who said that no deal would increase the risk of war in the region, he will now have to get it endorsed by Congress. He has made it clear that any legislation that prevents implementation of this deal will be vetoed.

The oil market has been speculating for months over how a deal would impact an oil market already struggling with increased supply from Saudi Arabia and Iraq together with robust and stable production from US shale formations.

The initial reaction was to sell **WTI crude** oil down towards the psychological level of \$50/barrel but the realisation that increased supply from Iran will not begin to be felt until next year helped stabilize the price.

Market share battle looming in 2016

Neither Saudi Arabia nor Iraq, which are currently producing at record pace, are likely to reduce production in order to make room for Iranian oil once it hits the market, probably during Q1 next year.

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Instead they will both be hoping that the continued rise in demand will be enough to make room and avoid another crisis of oversupply to emerge. Not least considering expectations that a sub-\$60/b price of oil could trigger reduced production from US shale oil producers still depending on a high price to break even.

Tehran is determined to reclaim its position as **Opec's** second largest producer after Saudi Arabia and this could cause renewed rivalries within the group, especially if oil fundamentals at that time fail to support increase supply.

US production robust for now

The recent increase in the number of operational US oil rigs has raised a few eyebrows considering the resilient message it sends to the market.

Despite a sharply lower price during the past year, the last couple of months of stable price action around \$60/b on WTI crude has been high enough to trigger a small revival.

This confirms the current belief that US oil prices at or above \$60/b are supportive for production and after the latest \$10b selloff, the question now remains at what level production will be hurt.

Adding to the recent price pressure apart from the Iran deal were the weekly inventory report from the US which, despite an overall reduction in inventories, showed a surprise rise at Cushing, Oklahoma, the delivery hub for WTI crude oil futures traded in New York.

If this trend is maintained for the remainder of the month, it would be the first time in five years where Cushing inventories rose during July and this could further add pressure to the US market where inventories are still some 100 million barrels above long-term averages.

There is now a risk that oil could overshoot to the downside despite the negative impact of Iranian oil not being felt until next year. Focus on supply destruction among US producers will eventually help the price recover. So while not ruling out a near-term risk of WTI crude oil testing lower towards \$45/b, we stick to our view that the most likely range this current quarter remains \$55-57.

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Source: Saxo Bank

Yellen, rising dollar sends gold bulls running

So far this July, gold has been swinging like a pendulum with an overall negative bias in response to the Greek crisis, Chinese stock market volatility and speculation about **the timing of the first US rate hike**.

This week we heard Federal Reserve Chair Janet Yellen repeating before US Congress that interest rates will probably rise this year. This statement and the general risk-on mood helped send the dollar higher and gold lower towards its longest losing streak since February.

Another Chinese secret out of the bag

The Peoples Bank of China on Friday updated its gold reserves for the first time since 2009.

During this time it had increased its reserves by 57% to 53.3 million ounces thereby overtaking Russia as the fifth largest holder of bullion.

China is the world's largest producer and a top two consumer together with India as well as having the world's largest physical marketplace, the Shanghai Gold Exchange. The impact on the market, however,

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was limited as it gave no details about when this gold had been accumulated as well as not mentioning any future intentions.

Beware of the bear trap

With gold now trading within 1% of the five-year low at **\$1,131/oz**, traders who bet on declining prices have so far been rewarded for building a record short position in the futures market. During the week of July 7 the net-long position held by hedge funds in futures and options fell to the lowest since at least 2006. This reduction was driven by a continued increase in the gross short position to a record of almost 11 million ounces.

A potential failure of seeing the price lower through the \$1,132-1,142/oz area of support is likely to trigger a small rally as bears book profit. However with the current call for parity between euro and dollars being voiced ever louder and with the uncertainty related to the impact of rising US interest rates, a bounce at this stage is likely to be viewed as a selling opportunity.

We however remain constructive on gold towards the end of the year and still view \$1,080/oz as the line in the sand below which gold will struggle to fall much further. We therefore view any additional weakness over the coming weeks as an overshoot compared to fundamentals such as cost of production and would see this as a long-term buying opportunity.



Source: Saxo Bank

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