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Weekly Commodity Update: Energy ebbs, coffee bitter, bears stalk gold

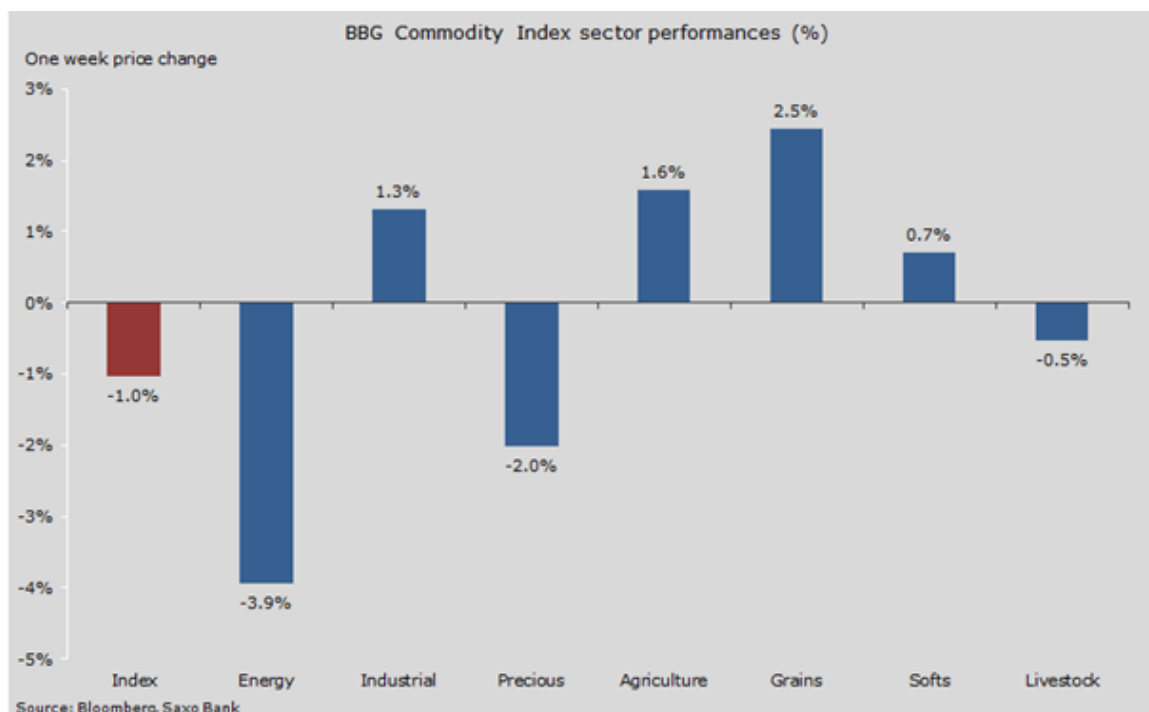
By Ole Hansen

Global stock markets remain nervous but the return to some sort of normality gave commodities the opportunity to look at other drivers. What they found triggered quite a mixed week with energy losing strength following the latest surge while the bears returned with another downside attempt on precious metals ahead of next week's long-awaited **Federal Open Market Committee meeting**.

Industrial metals went the opposite direction with the LME metal index jumping by 4%. This after copper received a dose of supporting news in terms lower supply from mine closures and potentially stronger demand from infrastructure projects.

The agriculture sector was mixed with key crops recovering ahead of a monthly report from the US Department of Agriculture on Friday. Soft commodities, such as cocoa, performed strongly while the cost of coffee went on sinking, not least due to continued deterioration in the value of the currencies of some of the major producers.

Cocoa reached its highest level since July as lingering doubts about the prospect for production from West Africa continues to offer support.



Chicago corn recovered ahead of a US Government report Friday which was expected to show a decline in both production and ending stocks (expected availability at the end of the 2015/16 season next August) compared with the previous month.

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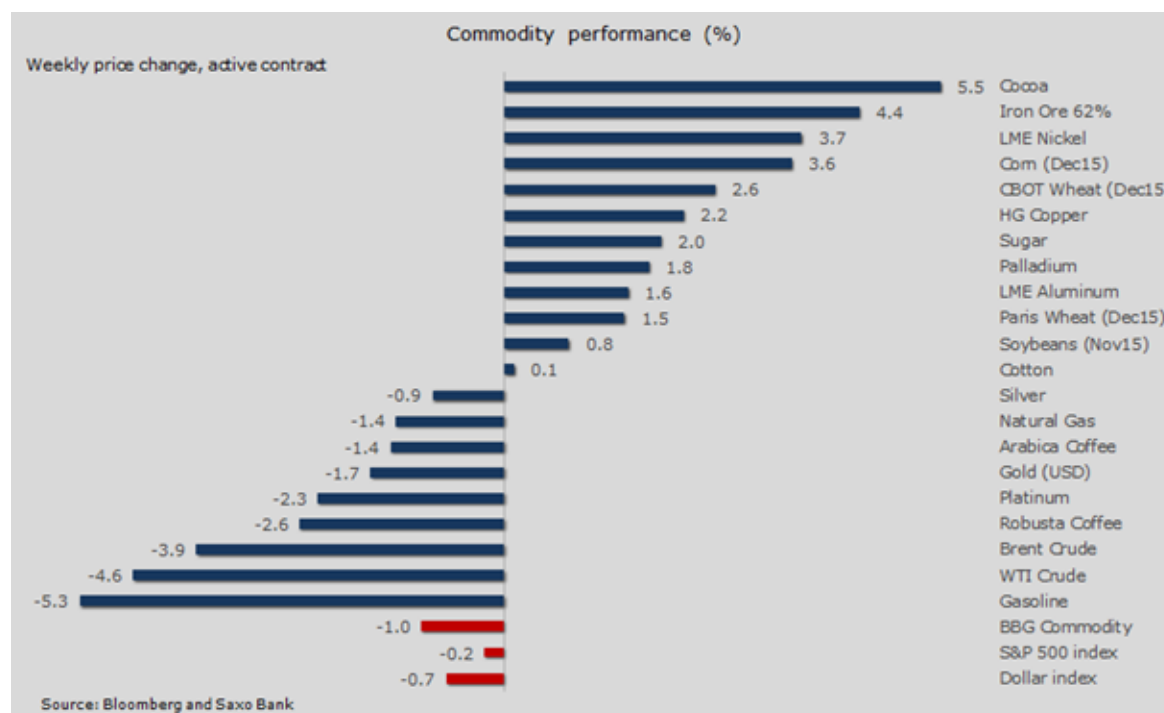
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Copper received a boost from Glencore's announcement that it would pause production in Zambia and Congo. Over an 18-month period this decision could remove 400,000 tons from the market. Congo has put up a fight against the shutdown as this would mean the closure of one of its biggest mines and impact the livelihood of 5,000 people.

After reaching resistance at \$249 HG Copper retraced some of its gains on the outlook that despite the recent announcement of production cuts a surplus is still expected for 2016. In our opinion the leaves the upside limited at this stage and we regard the \$249 to \$258 as the area where sellers will return.



The US driving season officially ended last Monday. It has been one the strongest for years due to the availability of cheap gasoline. During the coming weeks consumer demand for gasoline will begin to slow and this will lead to a reduction in crude oil demand from refineries. Lower refinery demand for crude oil will lead to a seasonal build in crude oil inventories and this is one of many headwinds currently keeping the price of oil from recovering at this stage.

Some light at the end of the tunnel, however, has begun to present itself, not least in the US where production is undoubtedly now slowing. The International Energy Agency in its monthly report on Friday saw supply begin tightening, especially outside Opec where production next year is now expected to contract its most since 1992.

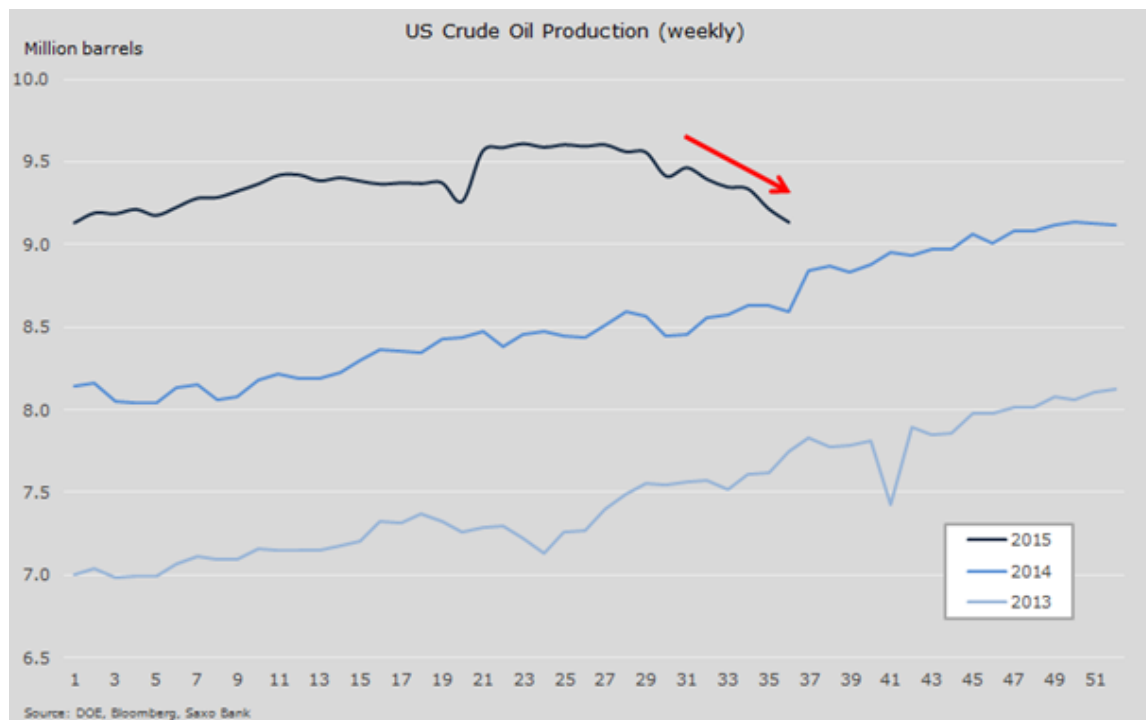
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Back in January the growth was still holding up at more than 1 million barrels per day but the slowdown seen in recent weeks will continue with the IEA now seeing the potential for a 400,000/bpd reduction next year.

Demand is expected to keep up, not least from China where the building of strategic reserves will continue to offset any potential slowdown from a weaker economy. But with global storage facilities brimming with oil and with increased exports from Iran next year the normalisation process is not expected to kick in for another year at least.

Short-term outlook

Although the future prospects for crude oil begin to improve this will do little to support the price in the short term. Global inventories are high and look set to increase further over the coming months. We see the very short-term range being between \$43 and \$47.5 with the risk skewed to the downside.

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Source: Bloomberg, Saxo Bank

However the risk of a renewed attempt below \$40 would be short-lived unless it is driven by a downwards revision to global demand growth. The recent sharp rally, where crude jumped 30% in just a few days and which was driven by traders having a one-dimensional view of the world, will deter financial traders from getting themselves to short again on any renewed selloff.

Gold bears return ahead of FOMC decision

The Chinese move to weaken its currency one month ago sent shivers through EM currencies and global stocks. Gold received a boost, not least from the covering of overextended short positions, but as we approach the long awaited decision from the FOMC next Thursday, September 17, gold is back on the defensive once again looking for support.

The US FOMC will meet next Wednesday and Thursday and the potential of seeing the first official US rate hike since June 2006 has once again put the yellow metal under pressure. We have long argued that the first US rate hike could potentially be a buying opportunity as it removes some of the uncertainty that has lingered over the market for the past three years.

However, for this to contrarian view to work the rate hike will have to be accompanied by a relatively dovish statement which could lead to market to conclude that future rate hikes will not be a given, considering weak economic developments outside of the US. At this stage the market sees less than a 30% chance of a rate hike and despite this the market has sold off this past week. This clearly shows the continued belief that the downside potential remains greater.

In the near term, traders will play gold from the short side looking for a break below \$1100 and only a swift move back above \$1118/20 can change the sentiment. The current return of negative sentiment was

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also seen in the daily flows in and out of the SPDR Gold Trust, the world's largest exchange-traded fund backed by gold this week saw the biggest daily outflow since July 31.

Our end-of-year call for gold at \$1250 remains but a break below \$1080 would trigger a revision.



Source: Bloomberg, Saxo Bank

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