ETF Securities: Update outlook olie, industriële metalen en agricommodities

Hieronder volgt een korte update van de vooruitzichten voor olie, industriële metalen en agricommodities in het Engels van Nitesh Shah, Commodity Strategist van ETF Securities.

Update Oil

Oil prices declined a touch below US$40/bbl earlier this month after having traded above US$50/bbl in in June. Unplanned outages in crude production in Canada, Kuwait, Nigeria have come down over the past two months while oil rigs in the US have been increasing over the past five weeks. Inventory of gasoline in the US also has been elevated sparking concerns that refiners demand for crude will wane as these stocks are drawn down.

Oil has now rebounded to US$49/bbl as the market has been encouraged by talks of market stabilisation by Russia and Saudi Arabia. Although production freezes have been discussed by OPEC members in the past, there has been a failure to reach an agreement, partly because the group did not want to lose market share to non-OPEC members like Russia. The potential willingness of Russia to participate could change dynamics. OPEC is now under new leadership and key OPEC delegates have changed since previous talks. Iran may also find it more palatable to freeze production, now that it is close to pre-sanction levels of output. Past failure to coordinate is not encouraging and hence we assume OPEC continues to modestly grow production.

Even when including an increase in OPEC production, we believe that the oil market is now broadly in balance (and in a slight supply deficit), after having spent the last two years in a production surplus. That will help eat into the elevated stocks. A US$1trn cut in investment in the oil and gas industry up to 2020, will significantly bite into oil supply over the next year, especially from non-OPEC, high cost producers. However, price gains may be capped because the US tight oil industry is very price responsive and will increase supply as prices move above US$50/bb. We therefore think the US$55 sets the upper bound for prices for the year ahead.

At the same time, US$40/bbl set the lower end of the trading range. In order to meet the demand for oil over the next 10 years more investment in oil is needed. That investment will not be forthcoming at prices below US$40/bbl.

Update Industrial Metals

After falling for most of the past five years, industrial metal prices have been rising in 2016. Year-to-date gains have been led by **zinc**, **tin** and **nickel** which have risen 41%, 26% and 16% respectively. However, we have by no means recovered losses that have been sustained in the down-leg of the cycle that lasted for close to five years. Industrial metal prices on average more than halved during the bear market as analysts revised their expectations for China's demand growth.

After decelerating since 2009, Chinese industrial output appears to be forming base, providing a platform for industrial metals to shake off the negative sentiment that has beset the asset class.

Zinc, copper and nickel are likely to be in a supply deficit this year, as mining activity has been pared back and demand remains robust.

Net speculative long positions in nickel and zinc futures contracts are over 1 standard deviation above their respective averages. That indicates long nickel and zinc are a crowded trade. We therefore think that price gains in these metals may have reached their limits for this year.

Copper has underperformed other industrial metals, barely returning 1% year-to-date. However, the fundamentals remain strong. The copper market is likely to enter another year of a supply deficit (the seventh in a row). China's rising infrastructure spending and recovering housing market bodes well for the demand for the metal. At the same time drastic cuts to miner capex will see the supply of the metal remain constrained. We believe that there is catch-up potential for copper.

Update Agricommodities

Sugar, **coffee** and **soybeans** have made spectacular returns this year, but much of their gains have been driven by currency movements, particularly the Brazilian Real.

The El Niño weather pattern led to a failed monsoon in India and unseasonably wet weather in South America in 2015/16. However at the time of onset of the adverse weather, the price of sugar, coffee and soy made only muted moves. The sharp depreciation of the Brazilian Real weighed on their performance as stocks of these commodities could be sold in US Dollars, providing millers and farmers with improved margins. When the Brazilian Real started to appreciate we saw the price of the commodities make substantial returns. Year-to-date, sugar, coffee and soybeans have returned 32%, 8% and 17% respectively

While difficult to predict the path of a currency that has been so volatile in the past few years, we believe that the good news about relative political stability (after the impeachment of the President Dilma Rousseff) has been largely priced in. Economic conditions remain challenging for the country and therefore limit significant further appreciation. We believe that currency appreciation will no longer be a meaningful catalyst for price increases in sugar, soybean and coffee for the remainder of this year and the crops will trade on their own fundamentals. Rising production should therefore be price negative.

Corn and **wheat** are headed for record high production this year. Strong yields in US, Russian and Australian wheat have countered a poor crop in the EU, which has suffered from too much rain. Planting of US corn has been one of the highest on record and the crop is progressing very well. Since their recent highs in June, corn and wheat have declined 25% and 18% respectively.

Looking to the next season, meteorologists are expecting a La Niña weather pattern to emerge this Northern Hemisphere winter. Historically such weather events which start in the winter tend to be price negative for wheat and price positive for sugar. The weather pattern encourages good snow cover in the US which helps maintain soil moisture levels for winter wheat and boosts the crop output. However, cooler weather in the southern hemisphere summer reduces the sucrose content of cane in Brazil (which produces about 25% of global sugar).

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