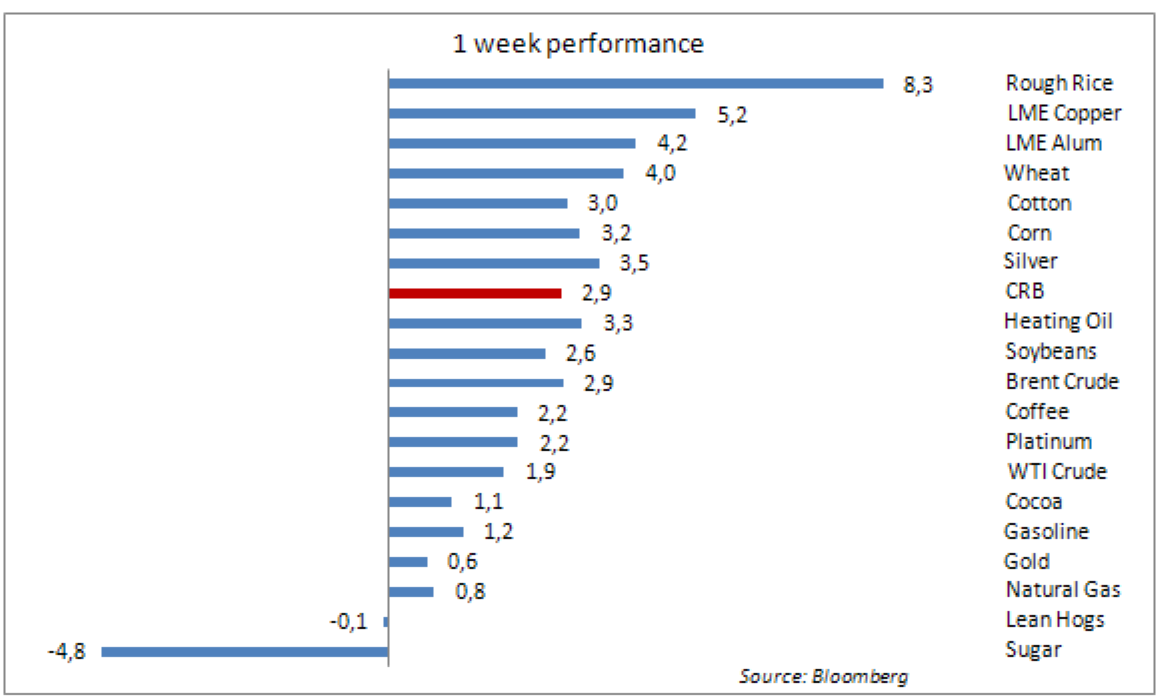
Commodity weekly: Geo-political worries and strong economic data drive commodities

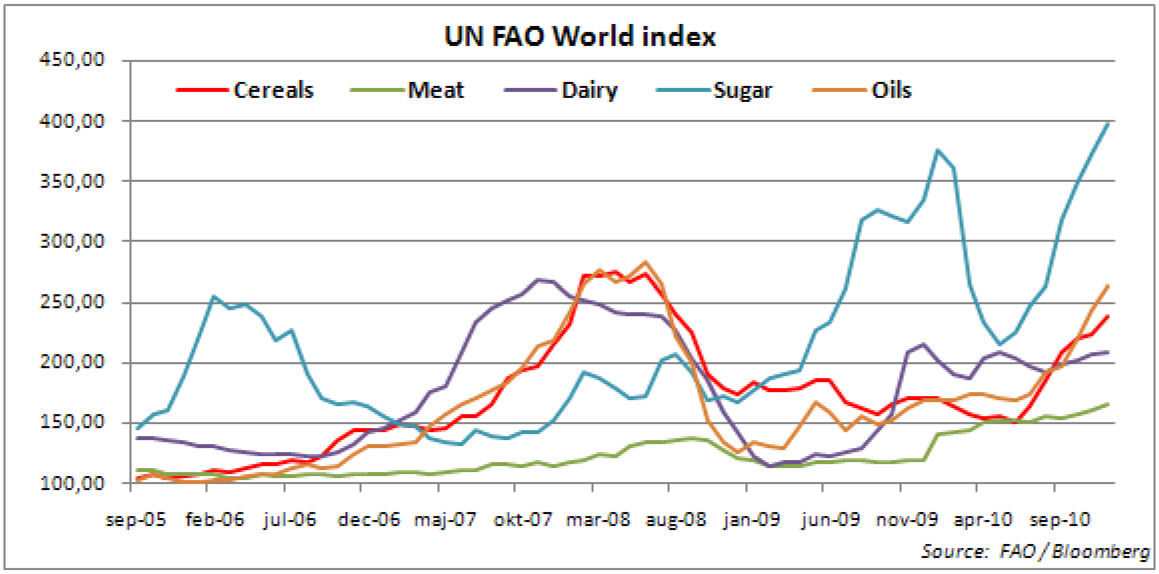
The winning streak of global stock markets continues with especially companies in energy and materials outperforming on the back of strong rallies in cyclical commodities.

The strength of the global economic recovery is driving commodities like base metals and energy higher and these two sectors have been the best performers during the past week, according to the DJ-UBS indices.

On the last trading day of January the Reuters/Jeffries CRB index cleared the 50 percent retracement level of the entire credit-crisis sell off. The move above 337 on the index was driven by a broad based rally with most commodities showing positive returns on the week.



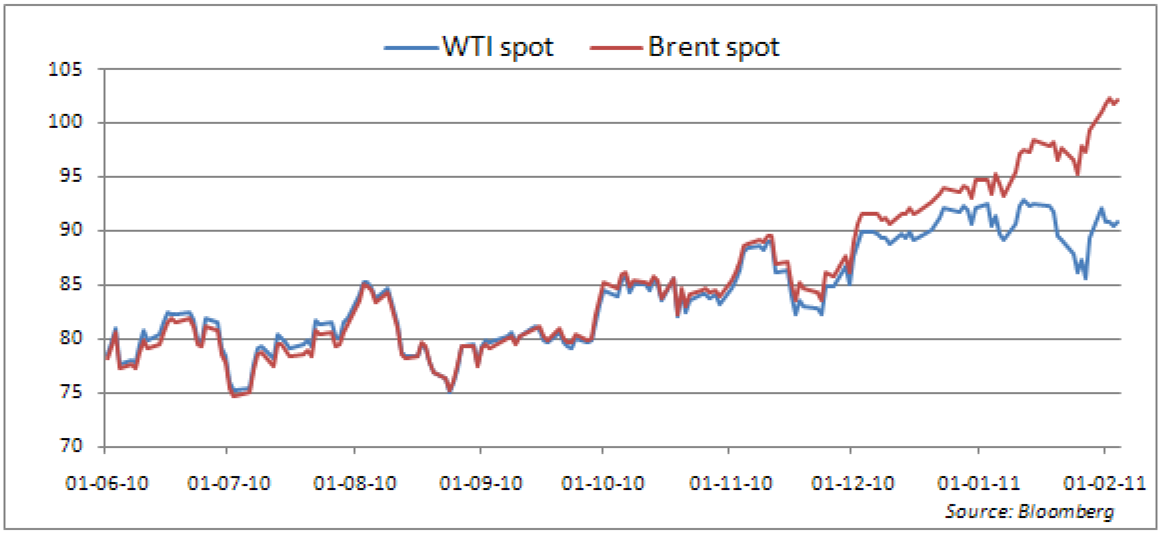
Record high food prices
The main headlines however continue to centre on food price inflation and the role it is has played in provoking unrest in North Africa. Global food prices hit a new record high in January, according to figures released by The United Nations Food and Agriculture Organization (UN FAO). The main index rose to 230.8, some eight percent above the previous record from June 2008, and it looks set to climb further in the months ahead on the back of hoarding to curb inflation and scarce supplies following the weather shocks in 2010.



Not as bad as 2008
There are however some indications that the situation this time round is not as bad as in 2008 when a genuine shortage caused the spike in prices. The cereal component of the index is still some 11 percent lower than the peak in 2008 as wheat stocks are still in abundance, with farmers holding back stock in anticipation of higher prices. The prices of wheat and rice, despite the recent rally, are still some 33 percent lower than the levels seen in 2008.

Oil above holding above USD 100
North Sea Brent crude has remained above 100 dollars this week on the back of geopolitical risk and increased economic activity. Meanwhile WTI Crude in New York continues to dislocate from the other global oil benchmarks having traded sideways some ten dollars below Brent crude. WTI stored at Cushing rose to a new record above 38 million barrels. Increased supplies from Canada is adding to the supply glut as they are going nowhere because U.S. refineries are enter the spring maintenance period, with lower demand being the consequence.

Historically Brent crude has been trading at a discount to WTI and once that discount rose too much the North Atlantic arbitrage kicked in with Brent crude being shipped across to the US and sold at a higher price. Now the opposite situation has developed but the arbitrage does not work the other way. Pipelines from the Mexican Gulf are currently configured to handle imports and run crude oil inland towards Cushing. Current export regulations also prohibit the export of domestically produced crude oil.



Industrial metals rising on strong macro data
Industrial metals, which have showed the strongest gains over the last week, continue to react to the continued run of positive economic data. Copper, widely used in construction and autos, reached the physiological and all-time high of 10,000 dollars per metric ton before succumbing to some profit taking. Concerns over tight global supplies combined with some loss of production from the cyclone affected area of Australia also helped support prices.

Gold recovers lost ground
After spending the past week consolidating, Gold broke back above 1,350 as geopolitical risk continues to attract attention. The Federal Reserve chairman Bernanke in a comment stated that the US economy was still too fragile to contemplate ceasing quantitative easing. As a result the market concluded that the current environment of low interest rates will continue for longer and thereby help gold to recover lost ground.

Investment flows out of gold ETPs has stabilised and could indicate that the recent selling pressure has eased. Near term the trading range looks like 1,325 to 1,360, while longer term the important technical support level at the 200 day moving average, currently at 1,290, holds the key just like it did during the last major correction in July 2010.

Volatility continues in agricultural sector
Turning to the agricultural sector elevated levels of volatility continue. Sugar reached 36 dollars, a thirty year high, over the feared impact of cyclone Yasi on Australian production. Once the market realised that the damage was less than feared the price tumbled. Computerised stop loss orders caused a cascade of selling which drove the price down by 12 percent.

Panic cotton buying on dwindling supplies

Cotton's horizontal rise continues to cause panic buying by mills. Floods in major cotton producing areas in Australia, Pakistan and China have hurt production at a time where demand has been rising. On Thursday the price of spot month cotton reached a new record of 181.22 on what can best be described as panic buying before sellers finally emerged driving it lower to 170.

The American cotton council removed some of the panic when it released a report indicating that farmers are now responding to higher prices by planning to increase their acreage dedicated to cotton in the current growing season. Once demand from mills has been met the market could be in serious danger of falling hard, also considering the elevated level of speculative interest of more than 3 million bales of cotton.

Acreage planning hurts rice short-term

One of the crops that could be losing out in the fight for acreage could be rice. Farmers in the U.S., the world's third-largest exporters, may reduce their rice acreage by as much as 25 percent once planting begins in April. The relatively higher price of corn, soybeans and cotton is the main reason for this switch. A strong rally in rice like the 8 percent seen during the past week could actually turn out to be helpful in the medium term as it could persuade farmers to stay with rice instead of switching.

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