Commodities: Iron ore agreement will cause steel prices to rise sharply

- Commodity market price changes were mixed in previous weeks. The favourable trend did, however, continue in overall terms. Demand stimulus primarily came from emerging markets, while growth remained moderate in the industrialised countries. The easing in agricultural commodities is welcome, as this will relieve inflation concerns in the emerging markets. In contrast, the latest change in iron ore supply contracts will have a dampening effect on the global economy, as it means that the steel sector in particular will be facing price increases.

- Energy: Good sentiment in financial markets, strong demand from the emerging markets and unchanged OPEC quotas are providing support for the price of oil (p.2). Base metals: The global increase in steel production is causing nickel prices to rise (p.3).

Commodity price movements

	Commodity	Unit	Price on 30/03/2010	Change in % compared to previous week	month	year
Energy	WTI	$/bbl	82.17	1.13	3.15	56.87
	Brent	$/bbl	81.34	0.79	4.83	69.49
	Gasoline	$/Gallon	2.26	0.23	8.78	51.98
	Heating Oil	$/Gallon	2.12	1.69	4.64	47.88
	Natural Gas	$/MMBtu	3.92	-4.00	-18.64	7.85
	Gas Oil	$/t	676.25	0.90	7.56	53.96
	GSCI Energy	Index points	1,015.1	0.33	2.25	30.23
Precious Metals	Gold	$/oz	1,110.30	0.98	-0.77	20.27
	Silver	$/oz	17.39	2.76	5.38	31.21
	Platinum	$/oz	1,627.90	1.66	5.72	44.32
	Palladium	$/oz	475.00	3.37	9.85	112.43
	GSCI Precious Metals	Index points	1,436.38	0.26	-0.64	19.95
Base Metals	Copper	$/t	7,745.00	4.28	7.94	69.49
	Nickel	$/t	23,980.00	7.76	13.58	148.99
	Aluminium	$/t	2,260.00	1.20	7.21	62.59
	Zinc	$/t	2,309.75	2.30	6.22	73.96
	Lead	$/t	2,129.75	-0.79	-0.78	67.50
	GSCI Base Metals	Index points	1,777.29	4.35	8.21	79.24
	GSCI Agriculture	Index points	523.23	0.23	-8.48	-6.12
	GSCI Livestock	Index points	2,184.08	1.11	3.47	-1.22
	GSCI Total Return	Index points	4,462.32	0.69	1.22	24.99

Sources: CFTC, Bloomberg, DekaBank
Note: The futures price refers to the next generic futures contract (generally 1-month term).

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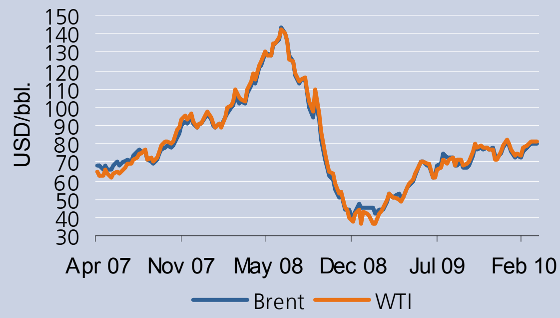
Energy

Equity markets and OPEC support oil price

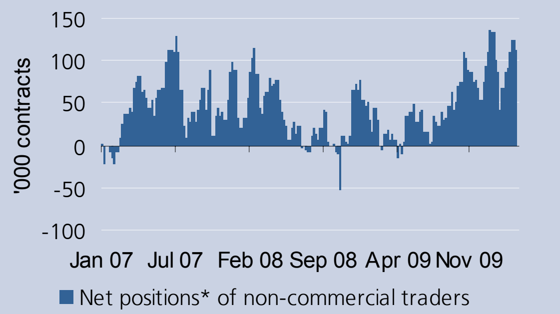
- Good sentiment in the financial markets has also provided price support for crude oil contracts. However, in spite of the equity market setting new highs for the year, the oil price has not yet been able to make a sustained departure from the trading range of USD 70 to 80 per barrel that has been maintained for months.
- As expected, the Organisation of Petroleum Exporting Countries (OPEC) left production quotas unchanged at their meeting in Vienna. OPEC is showing that it is fully satisfied with the trend in oil prices. In their estimation, the price is high enough to make new investments aimed at expanding production profitable, thereby preventing future shortages. On the other hand, it is not so high that it would present a danger to the recovery of the global economy. The markets received a clear message that OPEC would not do anything to push the price downwards again in the foreseeable future.
- The fact that oil prices have shown themselves to be unaffected by the ongoing weakness of US demand is also promising in terms of the current price outlook. US crude oil inventories, which were already high, have increased further. The lack of demand from the US is currently being compensated by demand from Asia and the Middle East. On the other hand, the large net long positions of speculators creates the possibility of a price setback. These positions could be fully or partially sold if speculation about further strong increases in oil prices were to dissipate. This could occur if the view became widespread that a price of USD 100 would be very difficult for the global economy to bear. The seasonal pattern also suggests that prices will decrease in the short term. We do not, however, expect the price to fall below USD 75.
- **Forecast:** We have revised our oil price forecast upwards for the current and following year. For one thing, the relative attractiveness of commodity investments increases as a long period of low interest rates becomes more likely. In addition, the upswing in Asia has continued to gather momentum and crude oil demand in this region is now strong enough to compensate for the weakness of demand in the industrialised countries. We are raising the average annual price forecast for WTI crude oil from USD 76 to USD 79 per barrel for 2010 and from USD 78.50 to USD 83.50 per barrel for 2011. We do not expect a sustained increase above the USD 80 mark to take place until the coming year.

Fig. 1 Oil price rising with little momentum



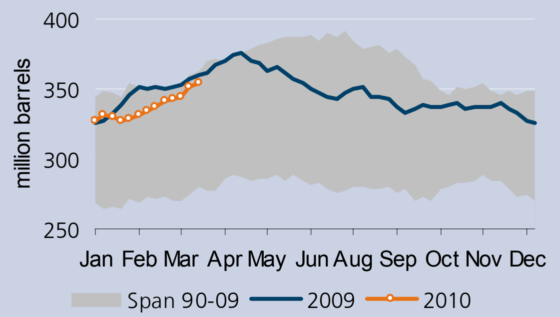
Source: Bloomberg, DekaBank

Fig. 2 Speculators remain optimistic



Source: CFTC, DekaBank
*A net positive (negative) position means that the majority is betting on rising (falling) prices.

Fig. 3 US crude oil inventories full to bursting



Source: Department of Energy, DekaBank

Table 1 DekaBank forecast for WTI

	March avg.	3 months	6 months	12 months
Price*	$ 81.30	$ 80	$ 83	$ 81

The 3-month price, for example, indicates that we expect WTI to have an average price of USD 80 per barrel in July 2010.

Base metals

Iron ore: a newcomer in derivatives markets?

▮ The prices of all base metals except lead rose in March. Copper and aluminium prices were approximately 7% higher on a month-on-month basis, and the price of zinc rose by more than 6%. Nickel is a clear winner among the base metals, both on a month-on-month and year-on-year basis, and is currently trading almost 135% above the price level of 2009. The steel sector, which uses approximately two thirds of total nickel production, is giving nickel an important fundamental boost. The demand for nickel is recovering rapidly in the US and European steel sectors, and steel production also remains strong in China. The turnaround in demand can be clearly seen in inventory changes (Fig. 6). LME nickel inventories have declined continuously since the beginning of the year.

▮ **Forecast:** The fundamental factors described above favour another increase in nickel prices. In the short term, however, concerns about the sustainability of the global economic recovery, government debt, or tightening of monetary policy in Asia could put prices under pressure.

▮ In March, major changes took place in the process of price formation for the other essential component of steel production, iron ore. For the past forty years, the price of iron ore has been set annually using contracts between major producers and consumers. As a result of dynamic growth in the Chinese demand for steel, a parallel spot market for iron ore gradually developed. This market gained steadily in importance, and now represents approximately 10% of total trading volume. The prices of long-term supply contracts will also now align themselves more strongly with the spot price, using quarterly instead of an annual adjustments. This should lead to a significant increase in iron ore and, therefore, steel prices over the short term, as spot prices are currently far above the levels set in the contracts (see Fig. 5). In general, the changeover to the new system will mean higher volatility of iron ore prices. Producers and consumers will presumably want to hedge themselves against this volatility. This demand for hedging should lead to the development of a derivatives market for iron ore based on the model used, for example, in the oil market.

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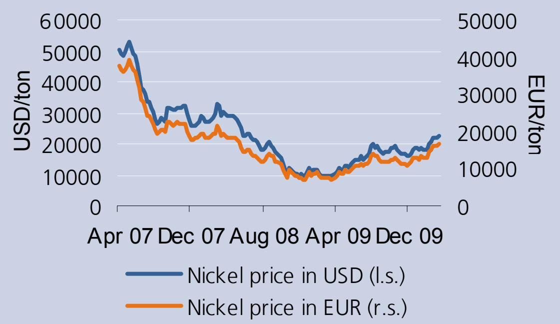
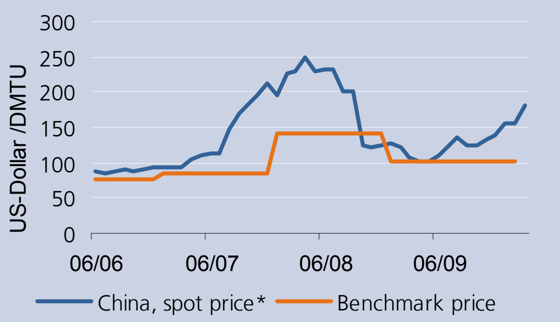
Fig. 4 Nickel prices



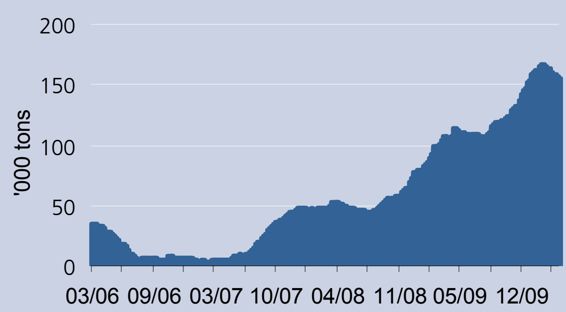
Sources: Bloomberg, DekaBank

Fig. 5 Iron ore: price formation differences



Sources: Bloomberg, IMF, DekaBank
* Shandong/Zibo, iron content 65 to 66%. DMTRU: Dry Metric Ton Unit

Fig. 6 Nickel: LME inventory



Sources: Bloomberg, DekaBank

Table 2 DekaBank forecast for nickel

	March avg.	3 months	6 months	12 months
Price*	$ 22,480	↑	↑	↑

*Price per ton. The arrows show the direction of change relative to the monthly average shown in the second column of the table.