


**Economic &  
Commodity Research**

# Commodity Spotlight

## Bear market or correction?

Energy*	current	1 day	1 week	1 month	1 year
Brent Blend	120.2	0.1%	6.9%	-7.1%	75%
WTI	121.2	-0.3%	6.2%	-5.6%	74%
Gasoline RBOB	941.0	0.0%	-0.8%	-11.0%	44%
Gasoil	1069.5	-0.4%	7.5%	-10.5%	75%
Diesel	1071.3	0.1%	7.6%	-11.4%	68%
Jet fuel	1180.3	0.0%	6.9%	-10.4%	75%
Natural gas	8.3	0.9%	2.9%	-17.3%	49%

Industrial metals**					
Aluminum	2850	-0.8%	1.7%	-6.9%	12%
Copper	7854	-1.2%	5.4%	-4.6%	9%
Lead	1905	0.0%	14.1%	-11.0%	-36%
Nickel	21495	-2.8%	11.8%	2.0%	-26%
Tin	21800	-1.6%	14.7%	-8.3%	49%
Zinc	1880	-1.9%	10.1%	0.0%	-41%

Precious metals***					
Gold	834.1	-0.2%	6.2%	-12.0%	26%
Silver	13.8	-0.3%	6.6%	-23.8%	18%
Platinum	1454.5	0.8%	6.0%	-18.9%	18%
Palladium	290.8	0.5%	-5.2%	-29.2%	-9%

Agriculturals*					
Wheat	897.3	-1.3%	7.4%	11.1%	23%
Corn	597.8	-0.7%	12.0%	3.5%	71%
Soybeans	1341.0	-0.5%	10.2%	-5.8%	61%
Sugar	14.1	-0.8%	6.9%	16.7%	48%
Coffee	139.9	-0.2%	5.1%	1.6%	22%
Cocoa	2658.0	6.2%	6.3%	0.0%	58%

Currencies***					
EUR/USD	1.487	-0.05%	1.24%	-5.83%	9.83%

\* 1-month forward, \*\* 3-month forward,\*\*\* Spot

### Commerzbank Forecasts

	Q308	Q408	Q109	2008	2009
<b>Crude oil and distillates</b>					
Brent Blend	124.6	110.0	106.7	113	99
WTI	125.6	111.0	107.7	114	100
Diesel	1170.0	1020.0	990.0	1075	915
Gasoline (95)	1150.0	1010.0	990.0	1000	933
Jet fuel	1240.0	1090.0	1040.0	1150	970
Natural gas	12.0	12.0	11.0	11.1	9.5
<b>Industrial metals</b>					
Copper	7750	7300	7100	7850	6900
Aluminum	3350	3450	3550	3150	3600
Lead	1950	2150	2300	2350	2350
Tin	22000	22000	22000	21100	22000
Zinc	1950	2150	2250	2150	2350
Nickel	23300	24200	24900	25500	25400
<b>Precious metals</b>					
Gold	1000	1100	1150	975	1100
Silver	20	21	22	19.0	21.4
Platinum	2000	2100	2200	2000	2125
Palladium	450	450	525	450	480

**Eugen Weinberg**  
+49 69 136 43417  
eugen.weinberg@commerzbank.com

**Carsten Fritsch**  
+49 69 136 21006  
carsten.fritsch@commerzbank.com

**Barbara Lambrecht**  
+49 69 136 22295  
barbara.lambrecht@commerzbank.com

On the basis of the S&P GSCI Total Return Index, commodity markets have lost over 20% since the beginning of July, which in theory constitutes a bear market. Consequently, it is now being claimed that this is the "end of the commodity bubble". We certainly do not agree with this view. True, we have warned about strong exaggeration on the part of some commodity prices, and in particular said early on that the oil market was the victim of speculative overheating. However, in our view the commodity sector is too heterogeneous for any talk of a bubble affecting it overall. Each segment needs to be seen in isolation, and while we see further scope for correction in the case of some commodities, there is still room for near term price gains in others, such as the meat market.

### Commodities hit by firm dollar and slowing global economy

The dramatic losses sustained on the commodity markets over the past few weeks appear at first glance like a bursting bubble: According to the S&P GSCITR, in which energy is heavily represented, prices have fallen more than 20%. The Jeffrey Reuters CRB Index, too, shows prices down almost 20% on the beginning of July. A number of factors have been responsible for the slump: One is the serious increase in potential risks, as for some weeks now the slowing US economy has certainly no longer been the only threat on the horizon. The loss of economic momentum in Europe and parts of Asia is equally worrying, and there are growing fears that China will not escape unscathed. In that case the main force behind the commodity boom would be seriously weakened. Another burden is the US dollar's latest advance. It has gained over 10 cents on the euro since mid-July, and the dollar index has risen more than 8%. Commodities had been used as a hedge against dollar weakness, meaning that they benefited from the declining greenback in the previous months.

### Correction not unique

The scale of the present correction is nothing new: The same thing happened in the second half of 2006 (see chart 1). The GSCI lost 20% in one fell swoop in the autumn of that year, and then an additional 10%. Then, too, fear of the global economy suffering a major downturn put pressure on prices. Oil dropped back from \$77 to almost \$50 a barrel, but the price then almost tripled within a year and a half.

This comparison alone puts the latest price losses into perspective, but in our view it is not enough for recent developments to be dismissed as a correction during a high with a passing reference to the parallels with the second half of 2006. It is vital to analyse the fundamental background, and before we take a look at various segments in this diverse market, we must consider the common driver behind the high, China. This is undoubtedly where the common key to the commodity markets lies.

CHART 1: Commodities should continue upward trend in longer term



Source: Bloomberg, Commerzbank Corporates & Markets

For important disclosure information please see page 6

**China still holds the key**

China’s vast appetite for commodities has been the driving force behind soaring commodity prices, and as far as catching up is concerned, we think this is still only the beginning. While China is the country with the biggest demand worldwide for metal, and the second biggest oil consumer, per capita consumption is still low. This is apparent from a number of examples: daily per capita oil consumption is less than 1 litre, compared with over 4.5 in Germany and 11 in the US. In the case of copper, China’s annual per capital consumption is 3.7 kg, as against double this volume in the US and four times the amount in Germany. Government measures to rein in growth should admittedly now gradually be taking effect, and monetary policy have been tightened drastically in an effort to check inflation and discourage unwise allocation of capital. And, not least of all, the economic slowdown in the industrial countries is taking its toll as well. All these factors will serve to slow the pace of growth, but domestic demand is still powerful enough in its own right, so we envisage the process of catching up to continue. The latest data confirm that the Chinese economy has largely decoupled. Despite a recessionary climate in the industrialised world, China just managed to achieve double-digit growth in the second quarter. Not to forget India, since its large population growth means that it too has considerable long-term growth potential.

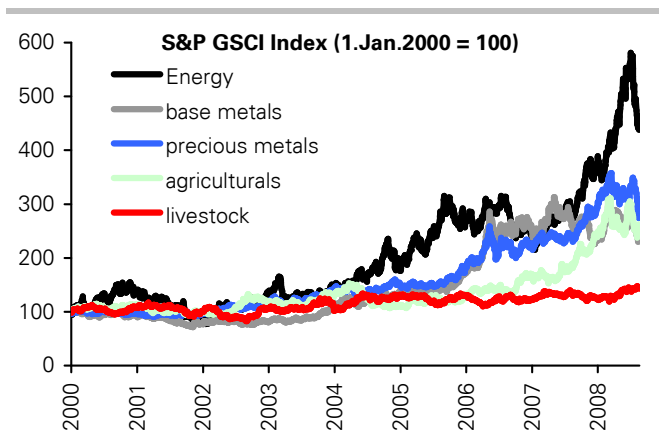
**Commodity market diverse: between burst oil-market bubble ...**

At a first glance, all the markets seem to be coming down to earth with a bang at the same time, but the situation isn’t that simple (see chart 2): Oil’s reversal has of course got the most attention. Since its high of just six weeks ago, crude has lost more than 20%, so that technically speaking oil is now in a bear market. It is worth bearing in mind, however, that the prior rally on the energy markets – Henry Hub natural gas also skyrocketed from the start of the year – was exceptionally dynamic. We have repeatedly warned of a speculative bubble in recent months, along the lines of ‘the higher they rise, the further they fall’. In our view, the latest retreat is a move towards a fundamentally justified price level of \$80 to \$100 a barrel. Given economic weakness and the prior overshooting, in fact, the price could fall even lower for a time. In the long term, though, we basically expect a considerably higher price level than a few years ago. For one thing, production costs (exploration, production and transport) have soared, and with concentration of production increasing, geo-political risks have intensified. In addition, demand in the emerging economies is rising steadily.

**...and cyclical correction in base metals**

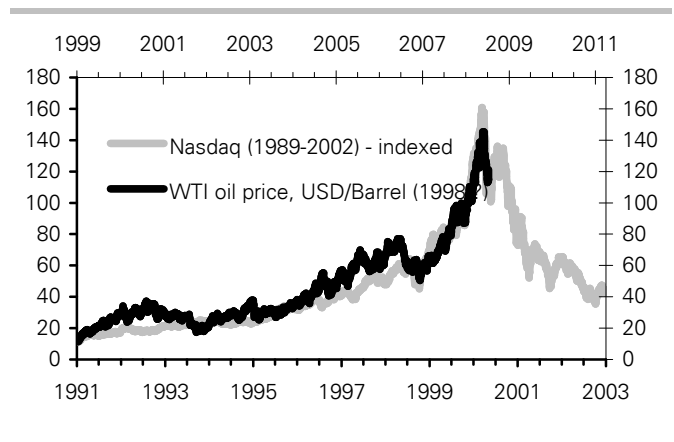
Base metals have likewise suffered severe losses in recent weeks. They have been more cyclical than energy prices also in the past. However, we feel that some metal prices have already reached a critical level in relation to production costs. Nickel, for example, has been traded just 10% higher than at the start of 2004, whereas production costs have soared. As a result, some mines that had been re-opened have become unprofitable again. Given this, supply growth can be expected to ease of again, while demand dynamics in the emerging economies remain buoyant. In addition, China’s output growth has been hampered by energy shortages. After the present cyclical correction, therefore, we see scope for gains in the longer term.

CHART 2: Heterogeneous commodity market

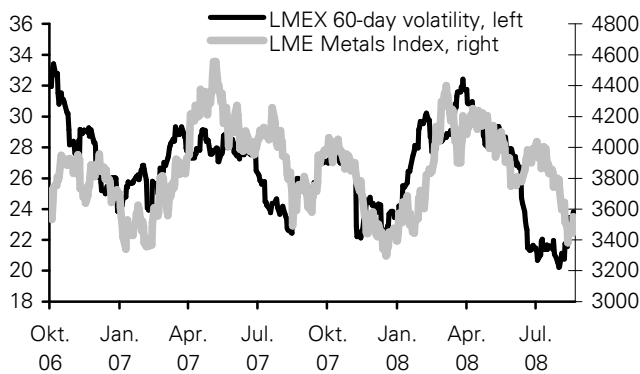


Source: S&P GSCI, Bloomberg, Commerzbank Corporates & Markets

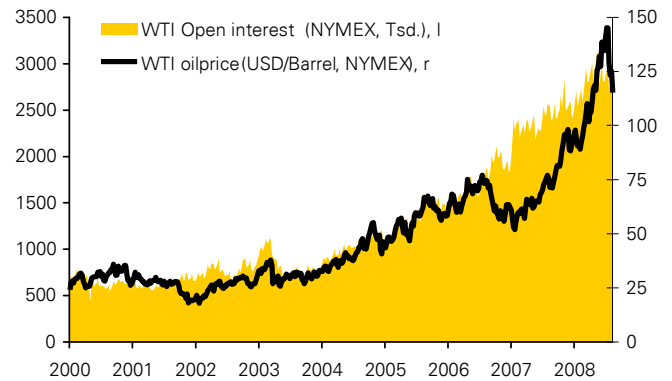
CHART 3: Crude oil: a kind of bubble lately



Source: Bloomberg, Commerzbank Corporates & Markets

**Chart 4: Rising volatility suggests that base metals should bottom out soon**


Sources: LME, Bloomberg, Commerzbank Corporates &amp; Markets

**Chart 5: Oil: long-term support for investor interest**


Sources: Bloomberg, Commerzbank Corporates &amp; Markets

### Renewed potential for gold gains

Gold differs from most other commodities. The economic cycle hardly plays a role, because its industrial use is so small. Two thirds of demand is from the jewellery industry, which has slumped in response mainly to high and volatile prices. Basically, though, strong income growth in the emerging economies – India is by far the biggest gold consumer – should mean that demand will pick up again once prices stabilised. With supplies stagnating at the same time, there should be additional scope for prices to rise, especially since investment demand should also increase at current lower prices. The holdings of gold ETFs already account for 40% of annual global output and should rise further, as investors will accumulate gold as a safeguard in the face of geo-political risks and the possibility of more bad news from the financial markets. One risk to this forecast, though, is the US dollar: If it were to make strong gains, gold could become less attractive. In addition, inflation is likely to fall substantially over the coming months, which could likewise put a break on gains in gold.

### ...and further potential for meat

Meat and livestock are the best examples of how heterogeneous the commodity market really is and that each commodity segment must be assessed separately. For a long time, meat and livestock bucked the trend and did not participate in the general commodity boom. This is also the only segment which posted gains in the present correction. We are bullish regarding the outlook for meat and livestock, as there is enormous scope for catching up, which we expect to proceed over the coming months. Impetus will come from growing demand for meat, especially in the emerging economies, the boost from soaring feeding prices, a medium-term decline in supplies and the discovery of this long-neglected segment by financial investors.

### Long-term upward trend for agriculturals intact despite correction

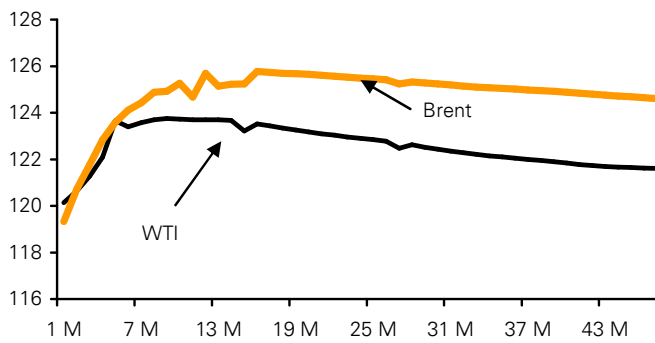
Agriculturals have been pushed lower by the general trend of falling commodity prices and have sustained major losses in some cases. Corn fell as far as 35% for a time, for example. Nevertheless, we are optimistic for most agriculturals in the long term, as growing demand for meat will mean a growing demand for feed. In addition, agricultural products play an important role in producing biofuels. And while demand is set to rise, supplies are limited, since it is not that simple to increase the acreage for grains. Moreover, increasingly erratic weather conditions constitute a threat to crop harvests.

### And investors?

Yet the critical question at the end of all is how much financial investors will be put off by the extreme volatility and the latest upsets on the commodity markets. Can commodities nevertheless establish themselves as an investment category in the long run even though, unlike bonds or equities, they bring no interest or dividend payments?

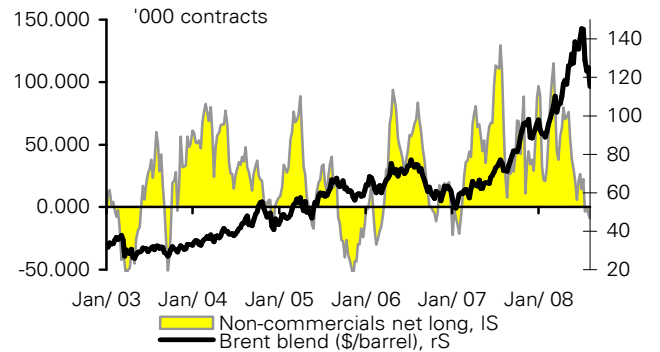
We still favour commodities to diversify an investment portfolio, and also expect the market to become increasingly efficient. At the same time, speculative excesses should become rarer as transparency improves. Commodities have developed over the past few years from purely economic goods whose prices depended solely on the supply and demand situation into a common investment class. Consequently, the speculative exaggeration witnessed is no more surprising here than on any other financial market, with frequent moves from one extreme to the other. This also explains why the present correction could last for six to 12 months and prove more severe than would fundamentally be justified. In the long run, though, commodities can look forward to more fat years.

**CHART 4: Crude Oil - Future Curves (WTI, Brent Blend)**



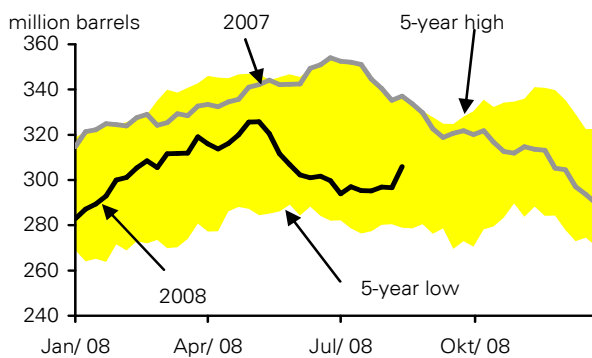
Source: Commerzbank Corporates & Markets

**CHART 5: Crude Oil: net-long positions of non-commercials**



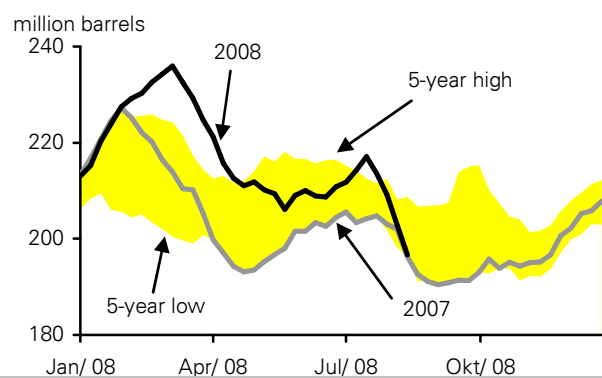
Source: Bloomberg, CFTC, Commerzbank Corporates & Markets

**CHART 6: Crude oil: US inventories (mio. Barrel)**



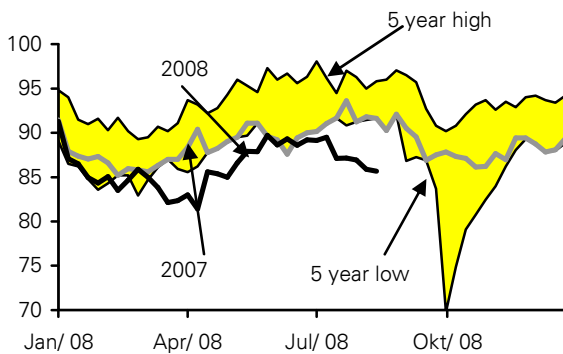
Source: Bloomberg, EIA, Commerzbank Corporates & Markets

**CHART 7: Gasoline: US inventories (mio. barrel)**



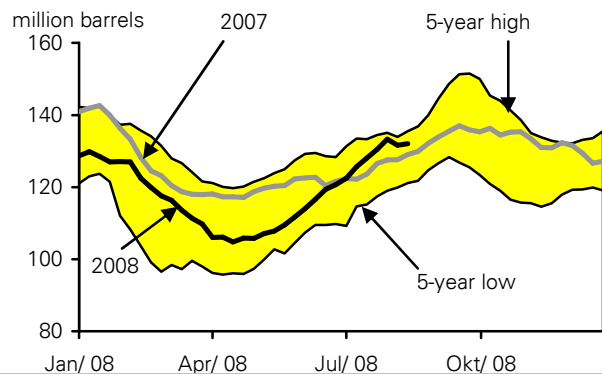
Source: Bloomberg, EIA, Commerzbank Corporates & Markets

**CHART 8: US capacity utilisation (refineries)**



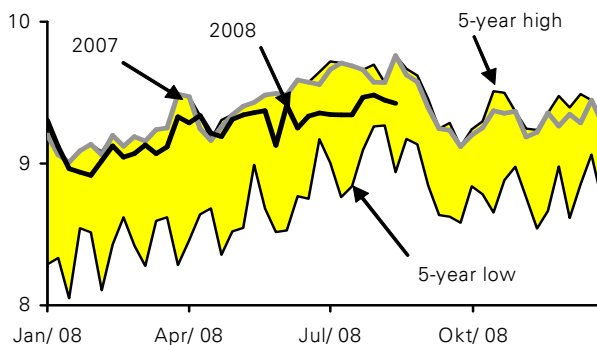
Source: Bloomberg, EIA, Commerzbank Corporates & Markets

**CHART 9: Distillates: US inventories (mio. barrel)**



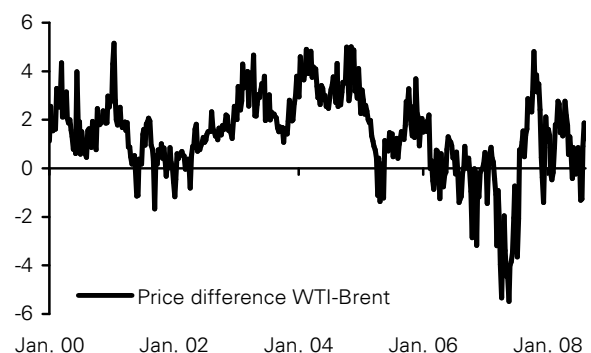
Source: Bloomberg, EIA, Commerzbank Corporates & Markets

**CHART 10: US gasoline demand (DOE)**



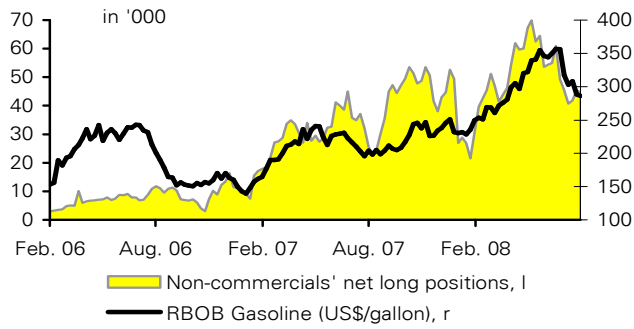
Source: Bloomberg, EIA, Commerzbank Corporates & Markets

**CHART 11: Price spread WTI and Brent blend**



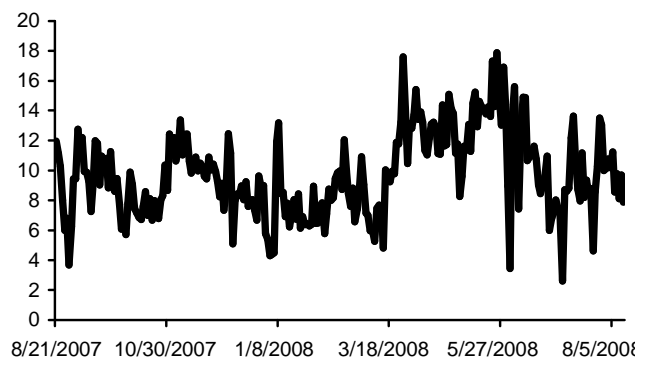
Source: Bloomberg, Commerzbank Corporates & Markets

**CHART 12: Gasoline: net-long non-commercial positions**



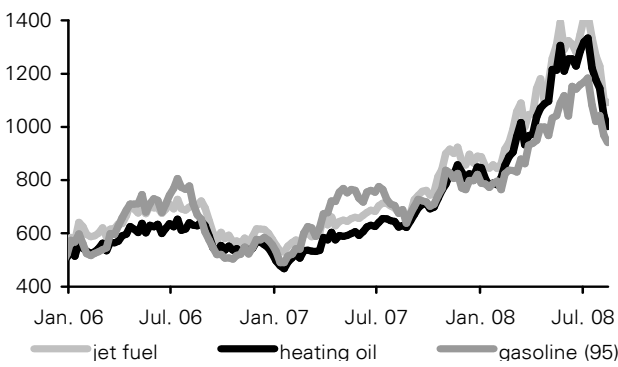
Source: Commerzbank Corporates & Markets

**CHART 13: Crack-Spread Brent 321**



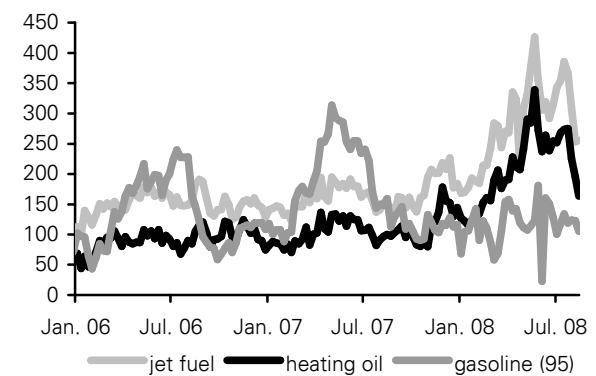
Source: Commerzbank Corporates & Markets

**CHART 14: Prices of distillates (in US Dollar per ton)**



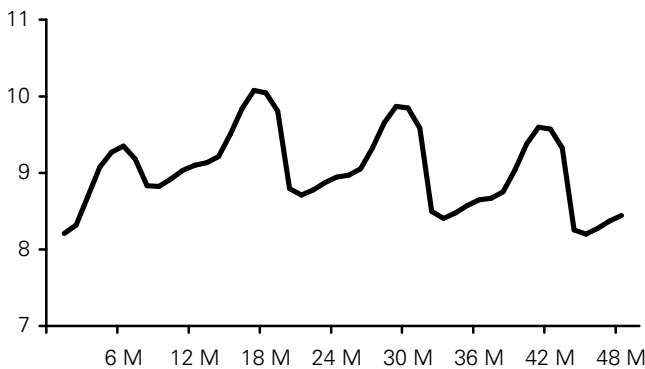
Source: Commerzbank Corporates & Markets

**CHART 15: Price spread distillates to WTI (in \$ per ton)**



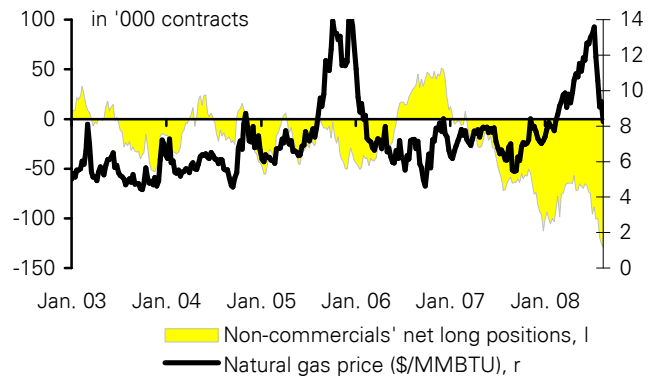
Source: Bloomberg, Commerzbank Corporates & Markets

**CHART 16: Natural gas – forward curve (Henry Hub)**



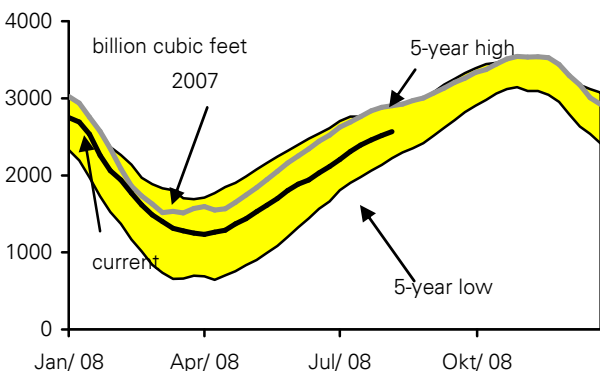
Source: Bloomberg, Commerzbank Corporates & Markets

**CHART 17: Nat. gas: net-long positions of non-commercials**



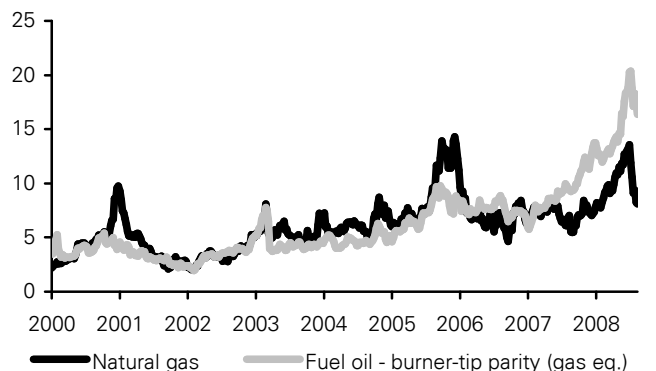
Source: Bloomberg, Commerzbank Corporates & Markets

**CHART 18: Natural gas: US storage**



Source: EIA; Bloomberg, Commerzbank Corporates & Markets

**CHART 19: Burner-tip parity (natgas vs. fuel oil no.6)**



Source: Bloomberg, Commerzbank Corporates & Markets

## Our forecasts at a glance

TABLE 1: In figures

	Unit	Current		Forecast						Annual average			
		22.8.08	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09	2007	2008	2009
<b>Oil/Gas market</b>													
Brent Blend	\$/bbl	118.3	96.6	122.4	124.6	110.0	106.7	101.7	96.7	91.7	72.7	113.4	99.2
WTI	\$/bbl	120.9	97.6	123.4	125.6	111.0	107.7	102.7	97.7	92.7	71.9	114.4	100.2
Diesel	\$/tonne	1063	898	1190	1170	1020	990	930	890	850	671	1075	915
Gas Oil	\$/tonne	934	820	1045	1150	1010	990	990	890	860	696	1000	933
Jet fuel	\$/tonne	1172	947	1254	1240	1090	1040	990	950	900	710	1150	970
Natural Gas (HH)	\$/MMBtu	8.2	8.7	11.5	12.0	12.0	11.0	10.0	8.0	9.0	7.1	11.1	9.5
<b>Industrial metals</b>													
Copper	\$/tonne	7973	7800	8450	7750	7300	7100	6950	6800	6650	7134	7850	6900
Aluminium	\$/tonne	2800	2750	2950	3350	3450	3550	3600	3600	3650	2640	3150	3600
Lead	\$/tonne	1902	2900	2300	1950	2150	2300	2300	2350	2400	2579	2350	2350
Tin	\$/tonne	22015	17800	22550	22000	22000	22000	22000	22000	22000	14496	21100	22000
Zinc	\$/tonne	1864	2450	2100	1950	2150	2250	2350	2400	2500	3252	2150	2350
Nickel	\$/tonne	21465	29000	25650	23300	24200	24900	25200	25500	25800	37126	25500	25400
<b>Precious metals</b>													
Gold	\$/oz.	827	925	900	1000	1100	1150	1050	1100	1100	693	975	1100
Silver	\$/oz.	13.6	17.6	17.2	20.0	21.0	22.0	20.5	21.0	22.0	13.4	19.0	21
Platinum	\$/oz.	1448	1879	2030	2000	2100	2200	2100	2100	2100	1292	2000	2125
Palladium	\$/oz.	293	443	445	450	450	525	500	500	525	356	450	480

Source: Commerzbank Corporates & Markets, Bloomberg

Quarterly figures are period averages

TABLE 2: In words

Crude oil	⚙️	On the back of weak demand, we expect the correction in the oil market to continue down to a fundamentally justified level.
Natural gas	⚠️	The boom in the first half of the year has again confirmed the close correlation with oil. We expect the gas price to outperform the oil price in the autumn and winter season.
Aluminium	🔗	We regard the latest rise in the price of aluminium as justified in principle, against the backdrop of rising production costs and weaker supply growth in China. Aluminium prices should rise further in the medium to long term.
Copper	♀️	The weakness of the US economy should lead to a correction in the coming months.
Nickel	♂️	Demand will rise strongly as stock depletion ends in the stainless steel segment while production data are disappointing at present. The potential for correction is exhausted in our view.
Lead	🔧	The improvement in supply at the same time as demand is slowing is likely to be fully priced in following the recent price correction. We thus look for prices to trend more-or-less sideways.
Zinc	🔒	The latest correction should entail numerous mine closures. We think the price will likely exceed USD 2000 this year.
Tin	🚫	Export and production restrictions in Indonesia are reasons for concern in a market where the demand-supply balance remains in deficit. This deficit coupled with strong demand will continue to support prices.
Gold	🔄	Gold is likely to regain value in the months ahead. Negative real interest rates in the US, stagnant mine production and strong demand for jewellery and investments should contribute to a price rise.
Silver	📈	Silver should manage to advance on gold's coat tails over the months ahead. The limited size of the market and mounting investor interest point to higher prices.
Platinum	🔄	Like all the precious metals, platinum is reaping the benefit of low real interest rates. Further support comes from shortfalls in the South African energy supply. We regard the latest correction as exaggerated and expect prices to rise soon. Slower demand from the automotive industry should be largely priced into the market.
Palladium	♀️	Palladium should benefit from the changeover of catalytic converters away from platinum. The introduction of ETFs by Züricher Kantonalbank and ETF Securities should ensure rising investor demand.

Source: Commerzbank Corporates & Markets

TABLE 3: Key events

9 Sep	OPEC Meeting
10 Sep	IEA Oil Market Report
16 Sep	OPEC Monthly Report

Source: Commerzbank Corporates & Markets

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Frankfurt	London	New York
Commerzbank AG	Commerzbank AG	Commerzbank Capital
	London Branch	Markets Corporation
DLZ - Gebäude 2, Händlerhaus	60 Gracechurch Street,	2 World Financial Center, 31 st floor,
Mainzer Landstraße 153	London	New York,
60327 Frankfurt	EC3V 0HR	NY 10020-1050
Tel: + 49 69 136 44440	Tel: + 44 20 7653 7000	Tel: + 1 212 703 4000
Fax: + 49 69 136 40357	Fax: + 44 20 7653 7400	Fax: + 1 212 703 4201