



ANZ Commodity Strategy

A rocky road ahead

August 2012

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Head of Commodities Research

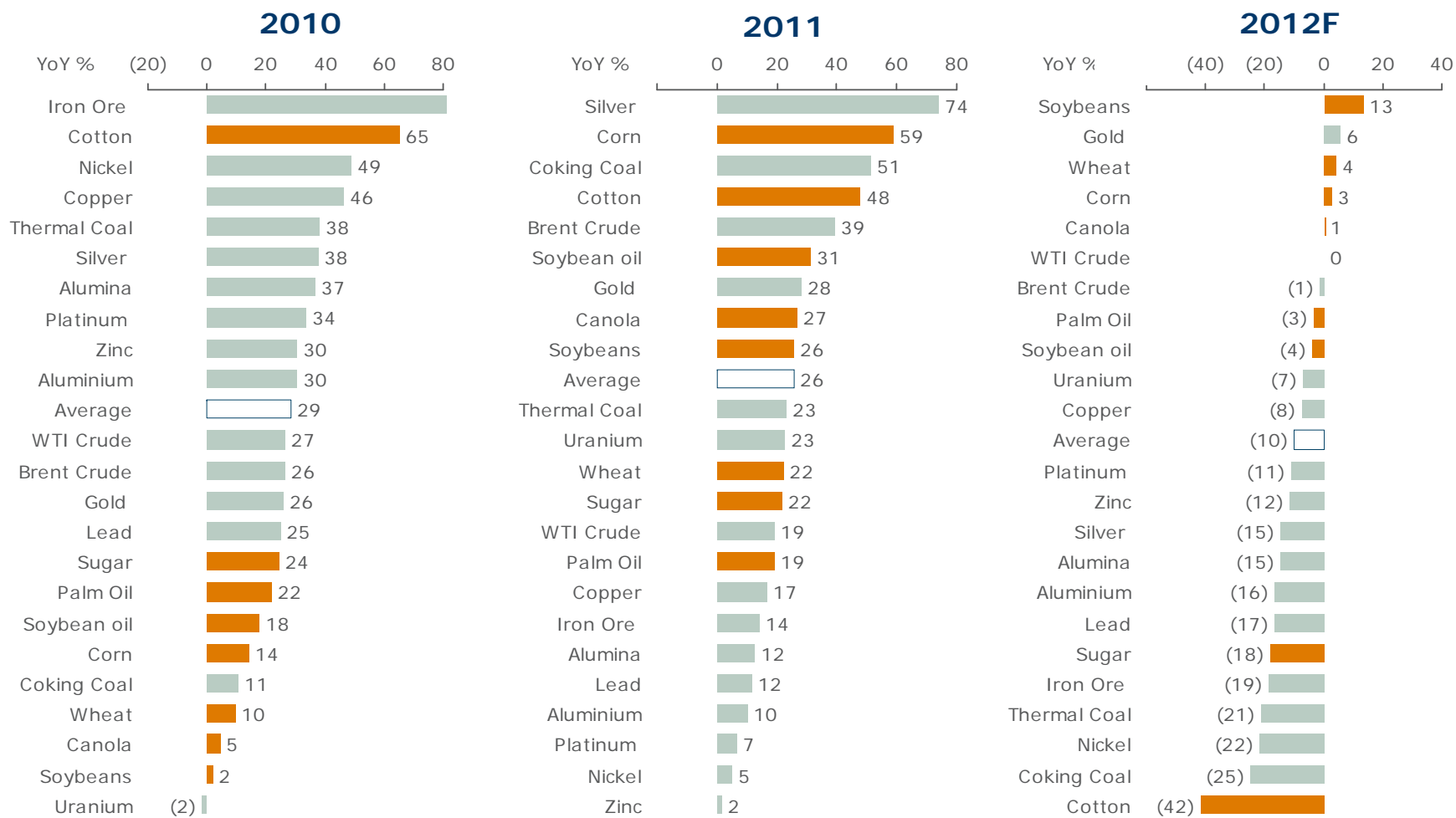


A rocky road ahead

- We expect commodity markets to remain volatile in the near term as wider market forces dictate sentiment for key investment fund flows. An uncertain European sovereign outlook and slower than expected Chinese growth is taking centre stage, with safe-haven flows into a rising US dollar adding an additional drag.
- An over-engineered slowdown in China has put the market on the back-foot. Participants are more used to a positive China backdrop and will be additionally concerned by the slower than expected response to recent government stimulus. We expect extra attention and analysis will be given to the near term data flow.
- However, sentiment can swing quickly, and we believe too much downside has been priced in to commodities. Although, we expect prices to fall an average 10% y/y in 2012 – at current spot prices we see gains of about 15% to our end of year forecasts.
- Key themes to watch for the rest of the year include the breadth of further Chinese monetary easing, the contagion effect of the European debt crisis, and the appetite of investment funds to reprice a bullish commodity market backdrop.
- An overpriced US dollar could retrace, supporting better commodity prices. We think gold would be the biggest beneficiary, with residual risk likely to remain around Europe and the Middle East.
- Political factors could also come into play – positively and negatively. China's leadership change should deliver a level of stability to the domestic growth story. On the flipside, US elections could be a negative distraction, with a focus on short-term internal political issues.

Prices are forecast to fall 10% in 2012, after 50% gains in the past 2 years - bulks and base metals will be the underperformers

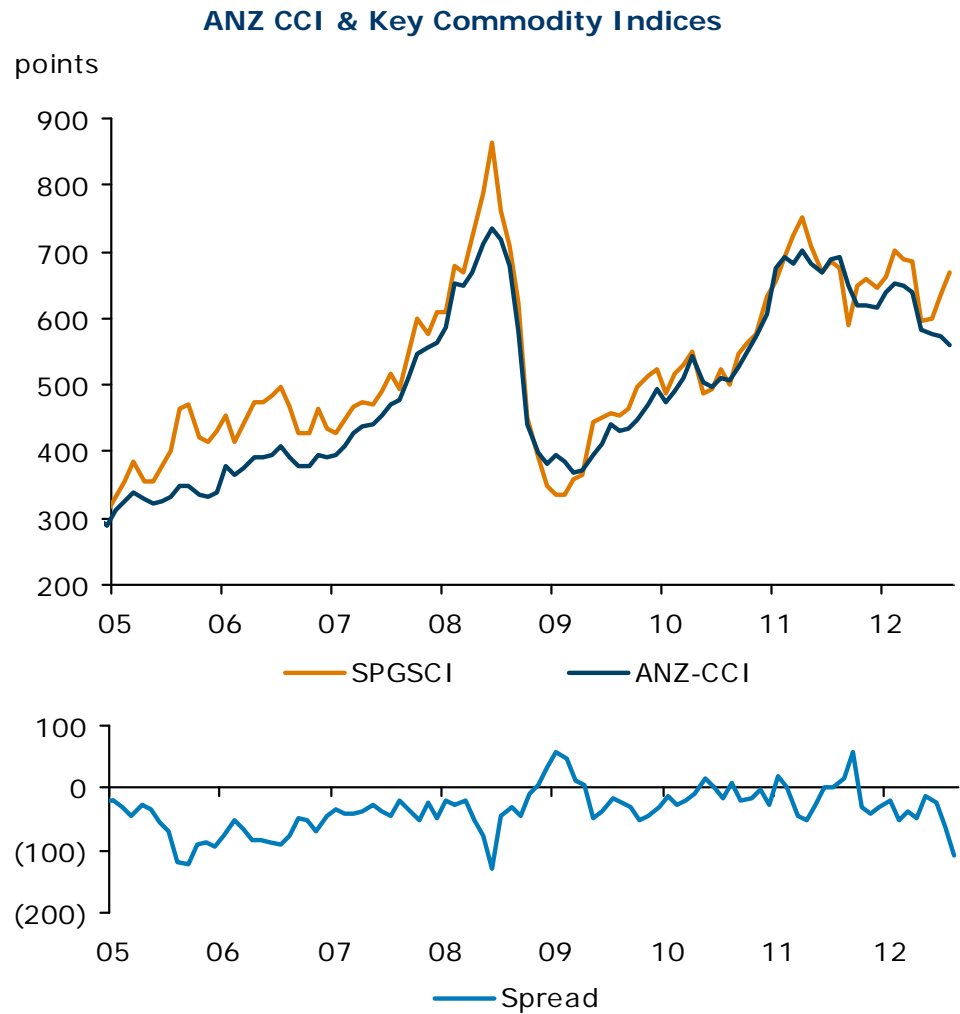
Average Annual Percentage Change



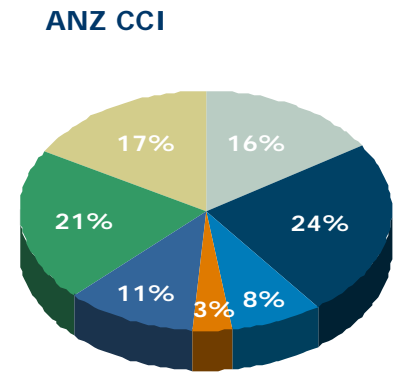
Sources: Bloomberg, ANZ Commodity Strategy



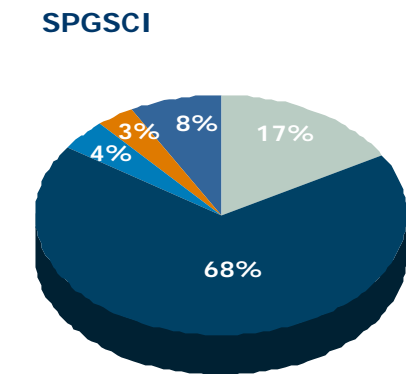
Our new ANZ China Commodity Index (ANZ CCI) has the unique inclusion of bulk commodities (coal and iron ore) – this can create divergence away from other well-watched indices



- Agriculture
- Energy
- Livestock
- Precious
- Industrial
- Bulks
- Thermal coal



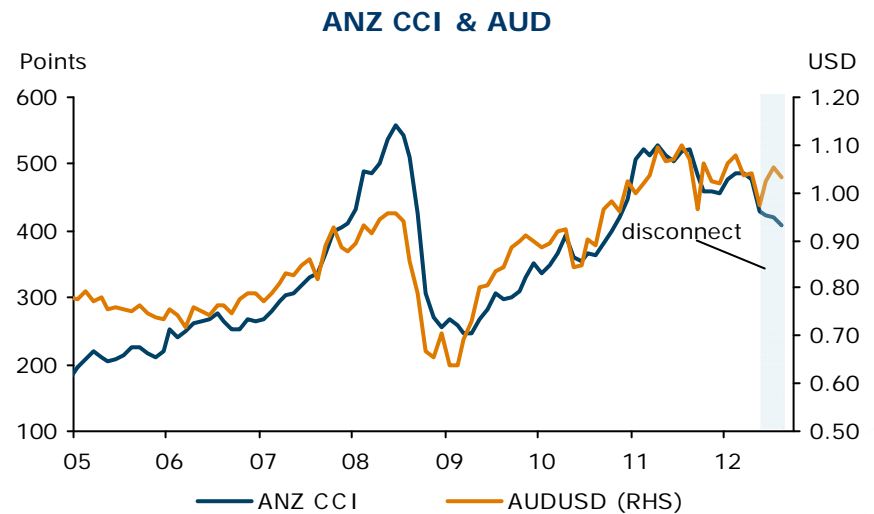
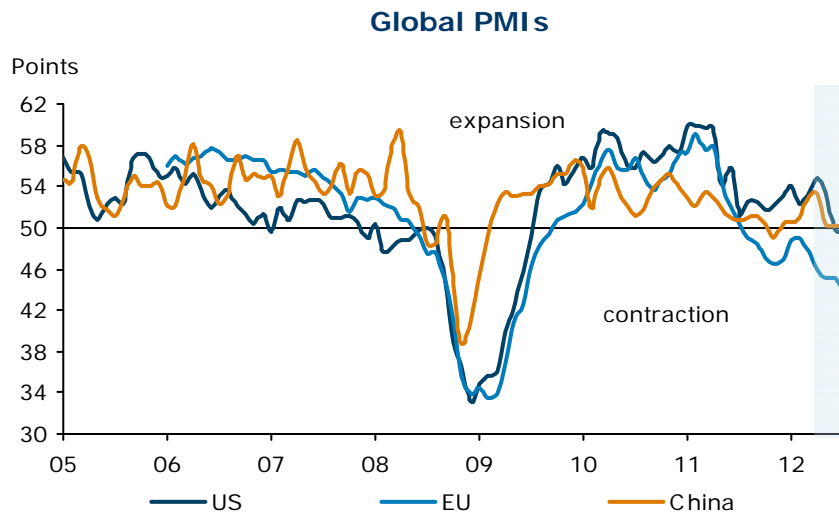
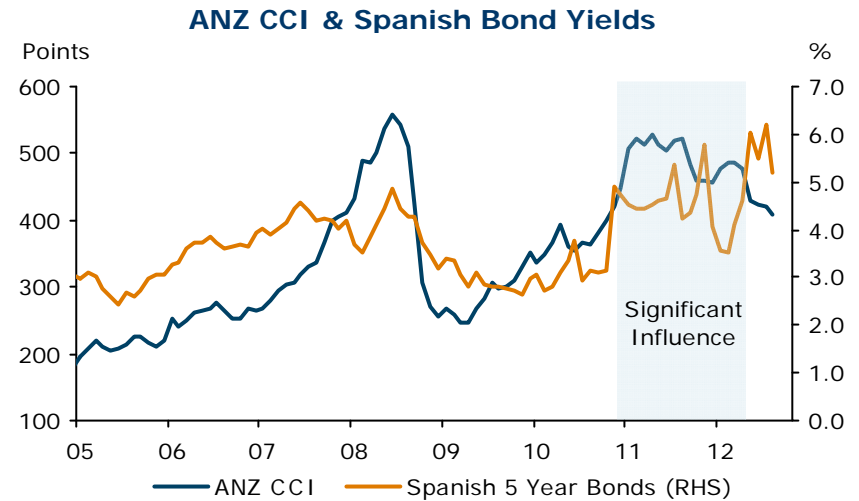
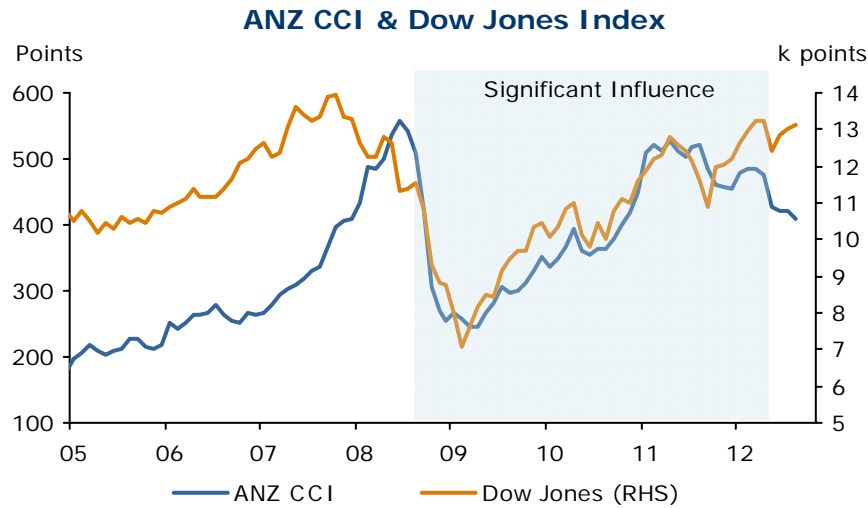
- Agriculture
- Energy
- Livestock
- Precious
- Industrial



Source: Bloomberg, ANZ Research



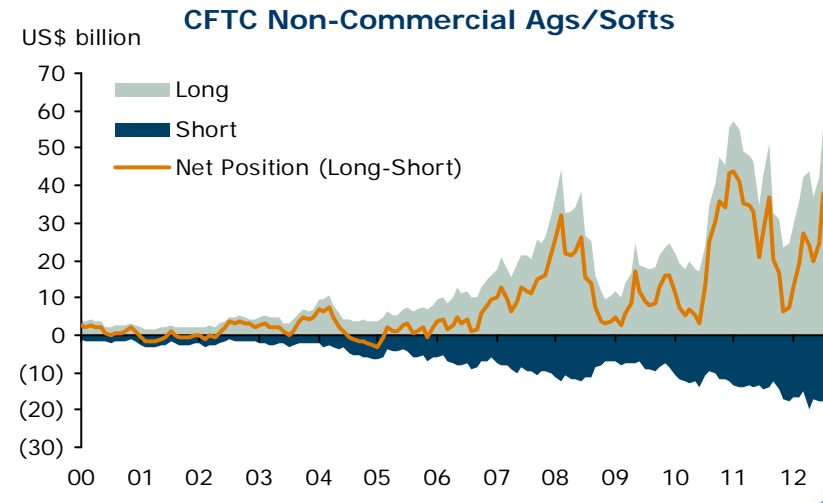
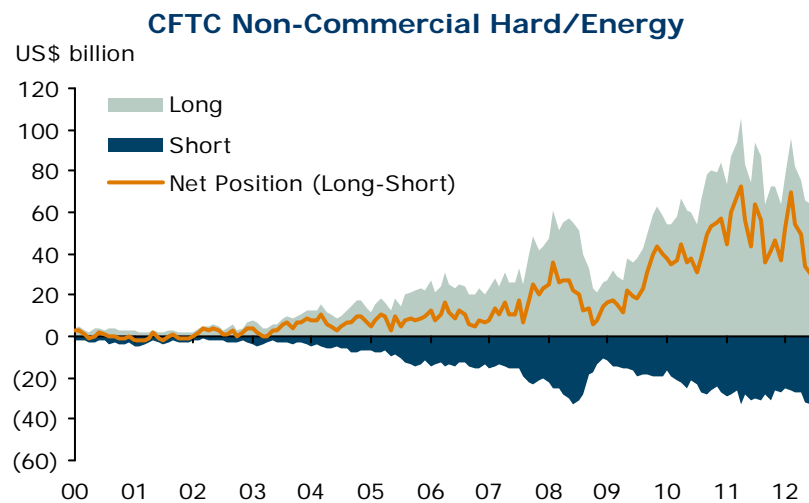
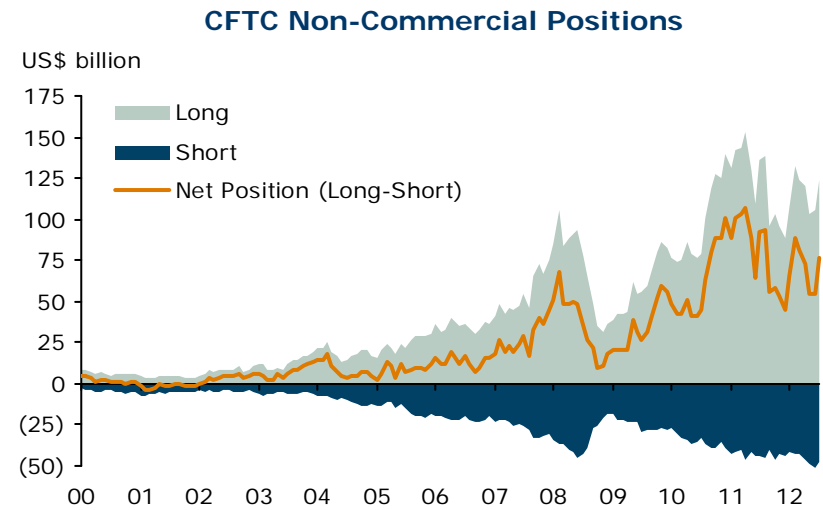
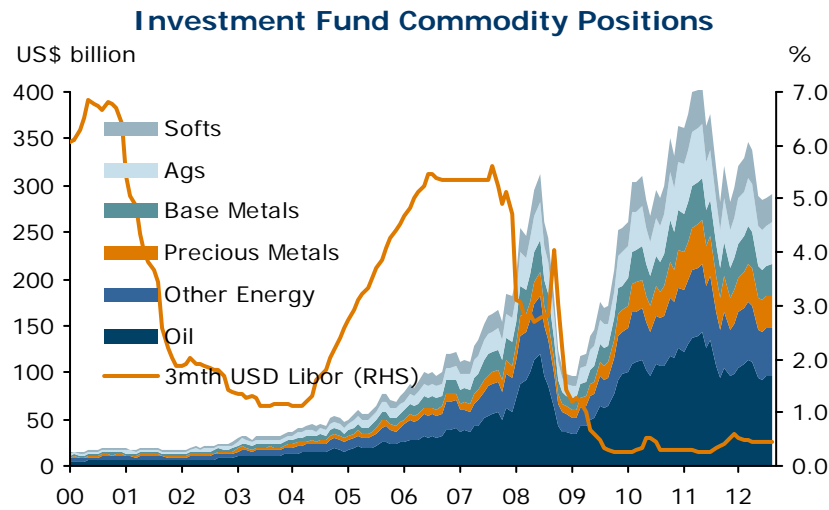
Fundamental drivers (PMI) now starting to outweigh sentiment-based equity and bond markets – divergence from the AUD will be a concern for the Aussie miners



Source: Bloomberg, ANZ Research



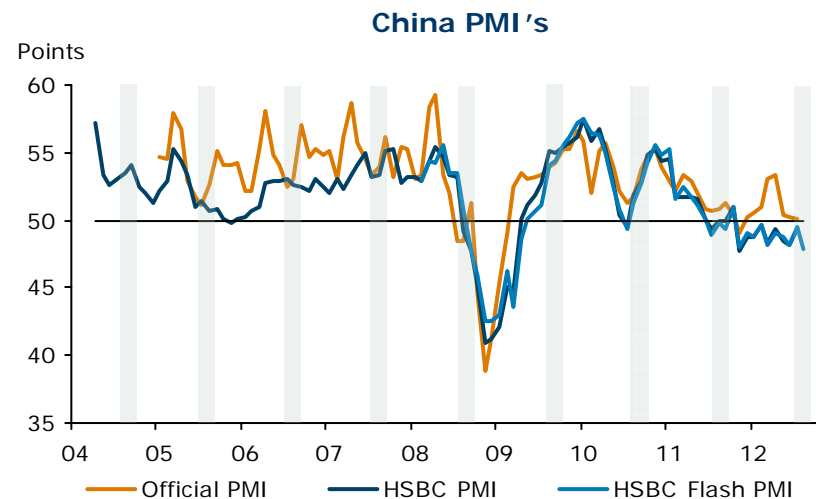
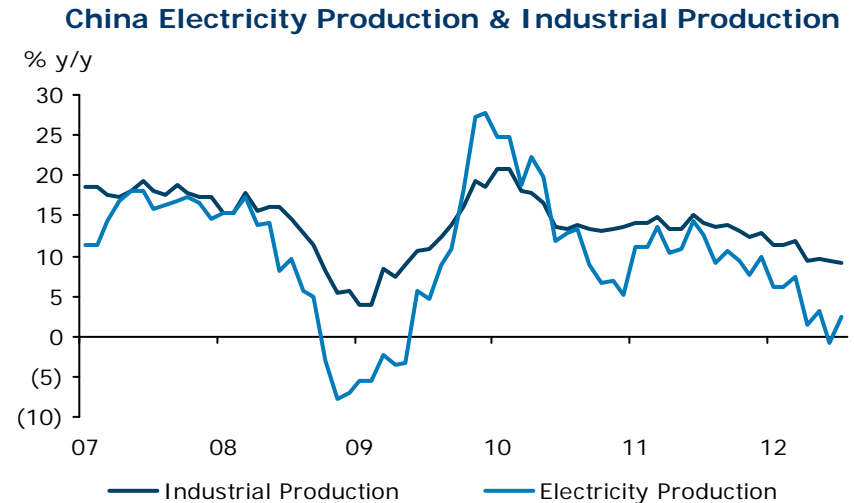
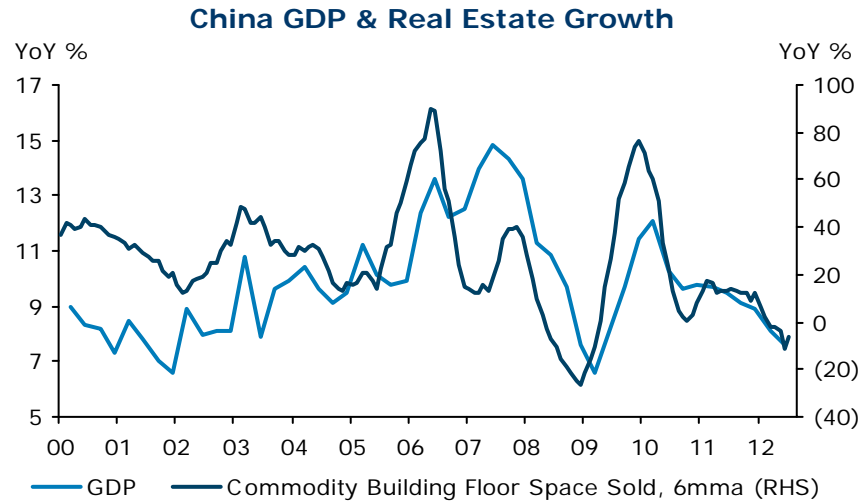
Investors have sold US\$70bn or 19% in commodity index fund positions in the past 5 months – *selling has been skewed heavily to hard/energy markets*



Source: Bloomberg, ANZ Research



Slowing China housing activity and energy demand has been a strong bellwether for weaker Chinese growth – external demand has been mixed, while PMIs may be set for a seasonal improvement

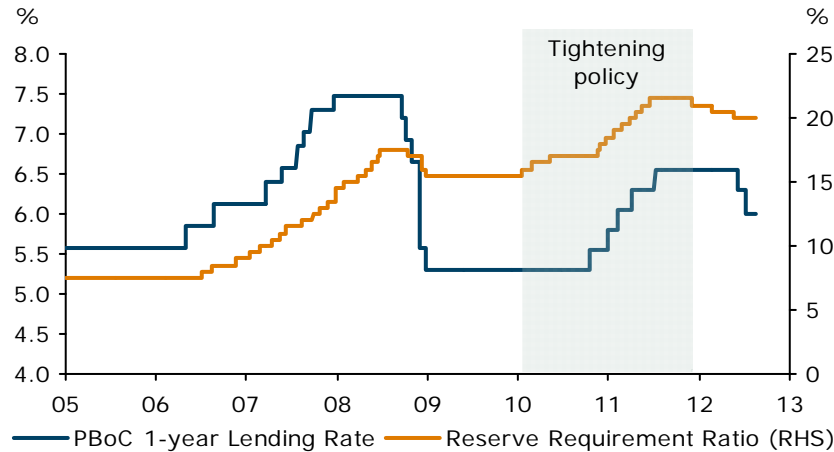


Sources: Bloomberg, ANZ Research



Loosening monetary policy is yet to translate into stronger investment spending – but improving m/m property prices may be the start of a housing pick-up

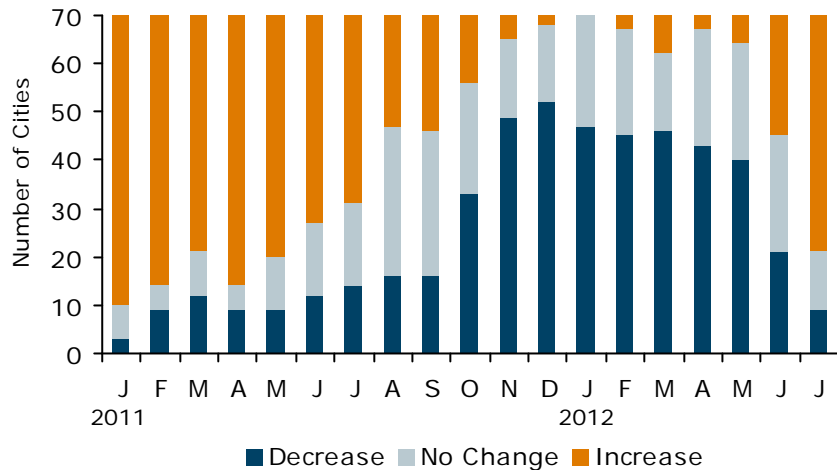
China Interest Rates & RRR



Government Budget Spending

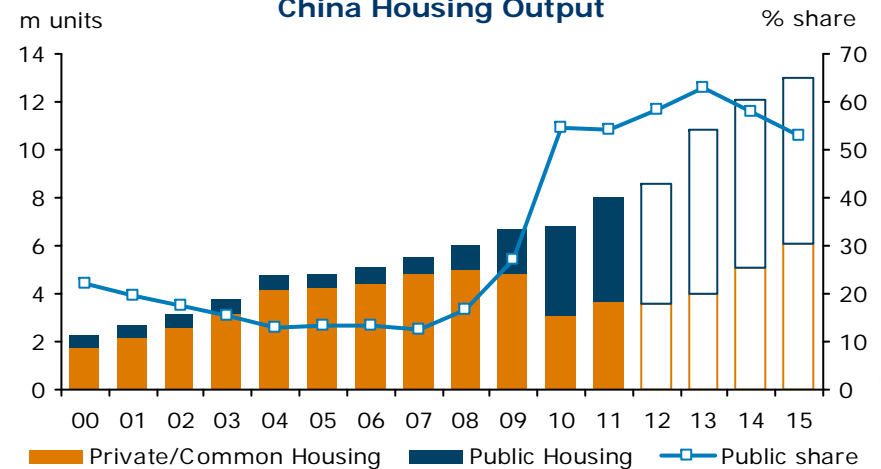
	Jan-May Spending (CNY bn)	Share of total expenditure to be allocated	2012 Target (CNY bn)
Education	608	34	1,790
Social Insurance	542	44	1,237
Rural Sector	353	33	1,082
Community	314	37	859
Transportation	257	33	779
Medical Care	236	33	726
Public Housing	100	25	402
Culture & Media	56	28	197

China 70 City New Residential Property Price Changes



Source: Bloomberg, ANZ Research

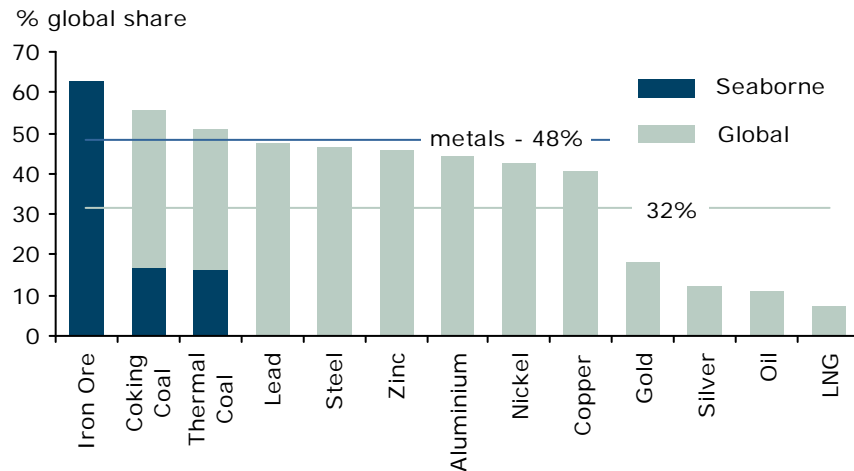
China Housing Output



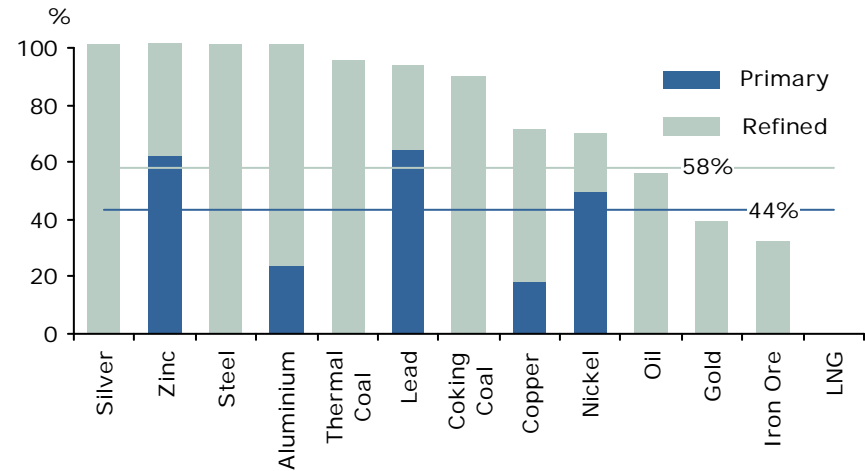
China now consumes close to 50% of the world's commodities

- it is also a very large producer of commodities, but it less self-sufficient in primary supply, such as bauxite, copper concentrates and iron ore

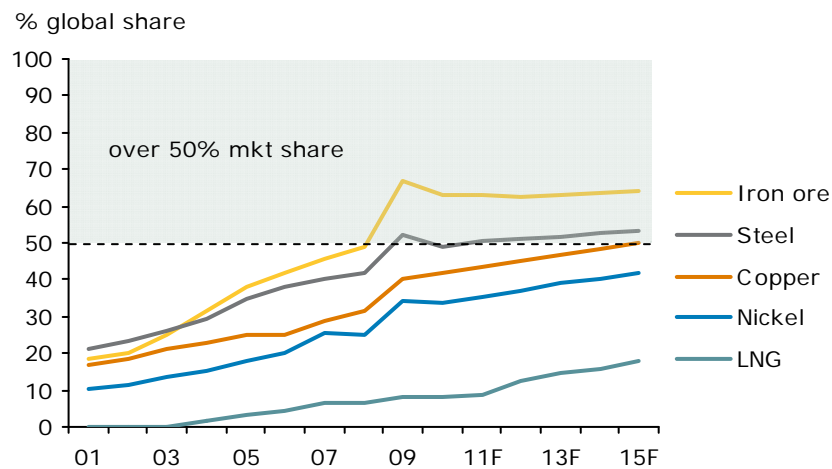
China's % of Global Consumption



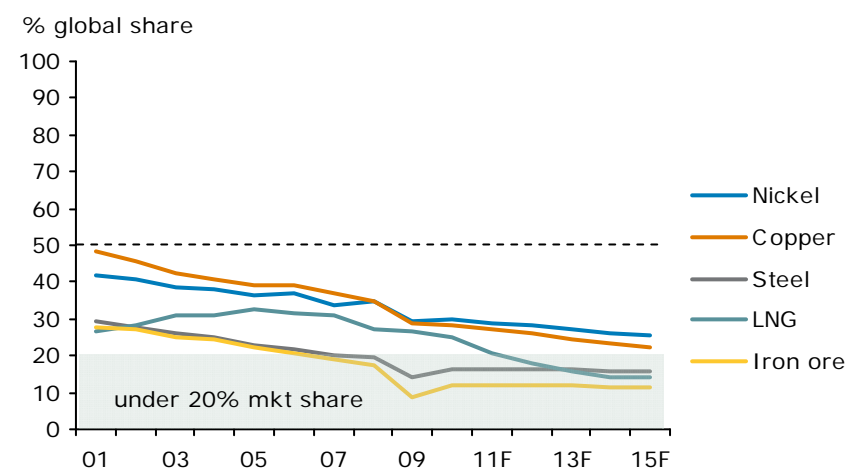
China's Self-Sufficiency



China's Global Market Share of Demand



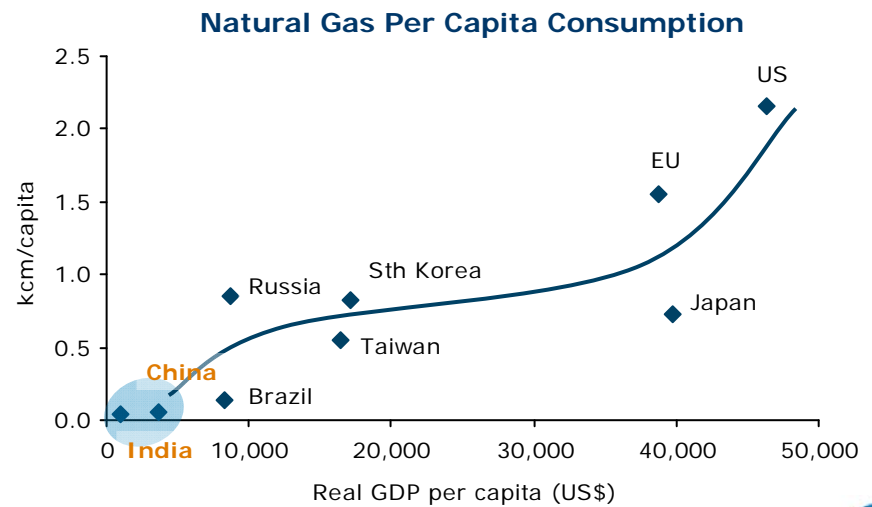
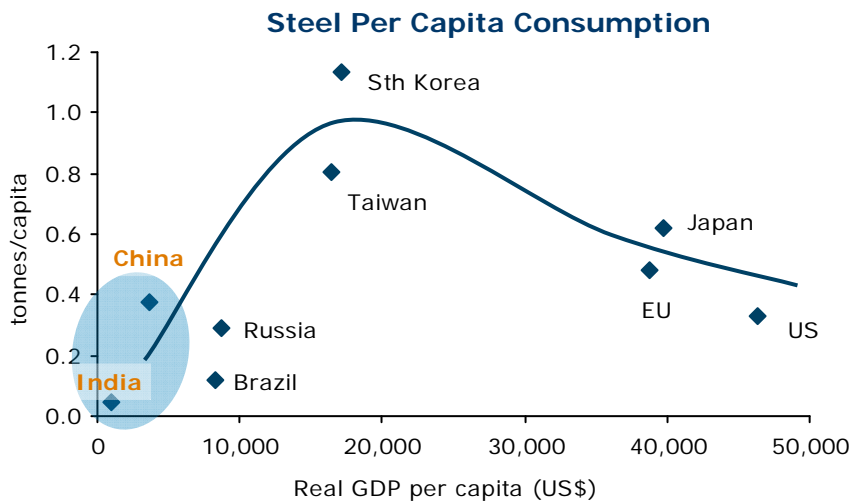
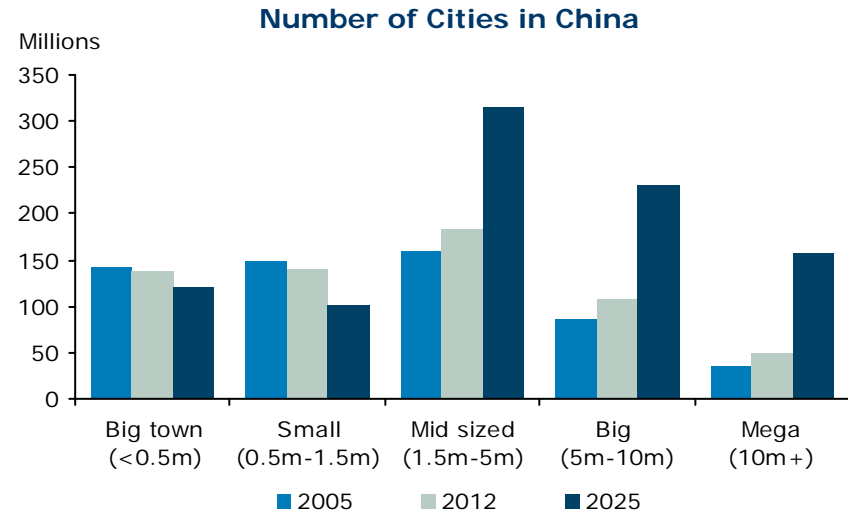
US & Europe Global Market Share of Demand



Note: Seaborne iron ore, coking coal & thermal coal for China's % of Global Consumption
Sources: WoodMac, ANZ Research



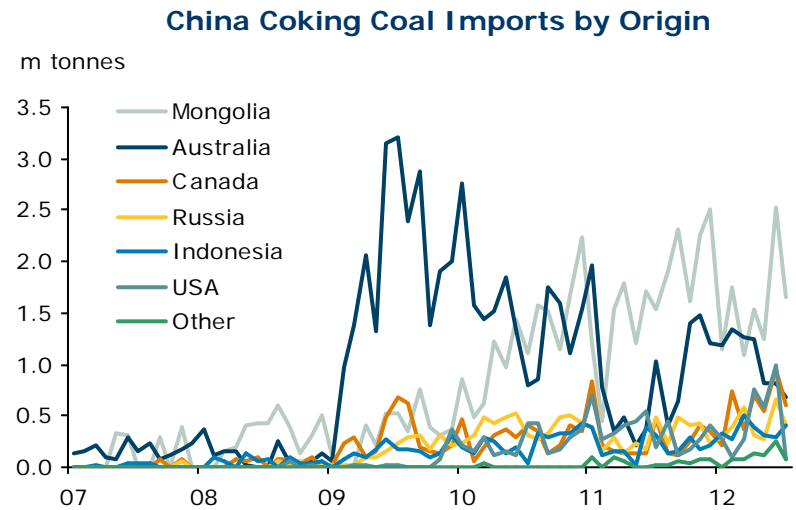
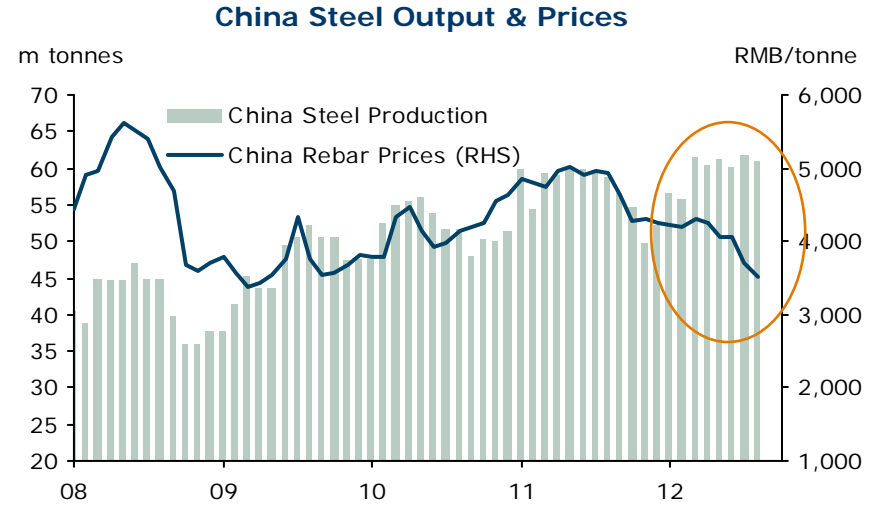
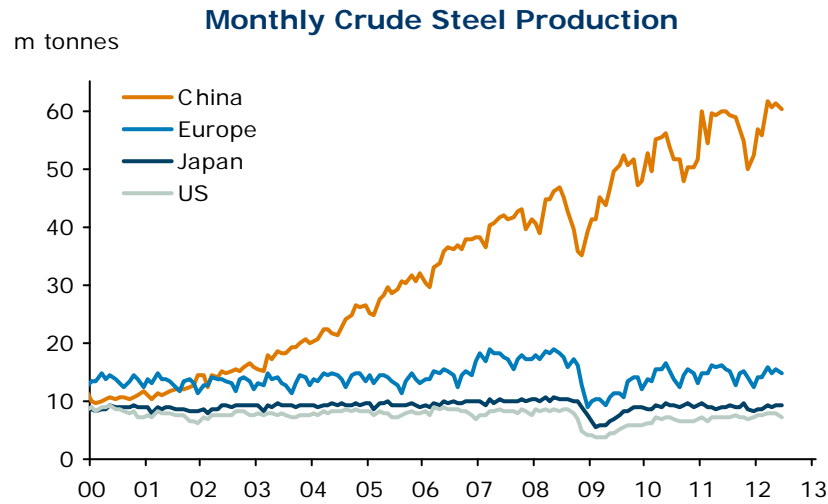
Stronger long term commodity demand still seems assured – 300 million more people need to be urbanised into much bigger cities, requiring huge amounts of steel and energy



Source: ANZ Research

COAL

Falling China steel prices is squeezing steel mill margins and should force closures of high cost supply – Mongolian coking coal imports would be most affected and are already coming down



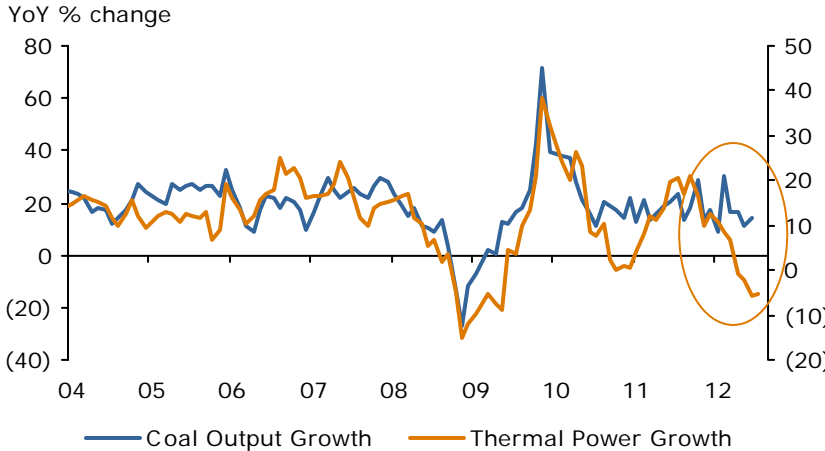
Source: Bloomberg, World Steel Association, ANZ Commodity Strategy



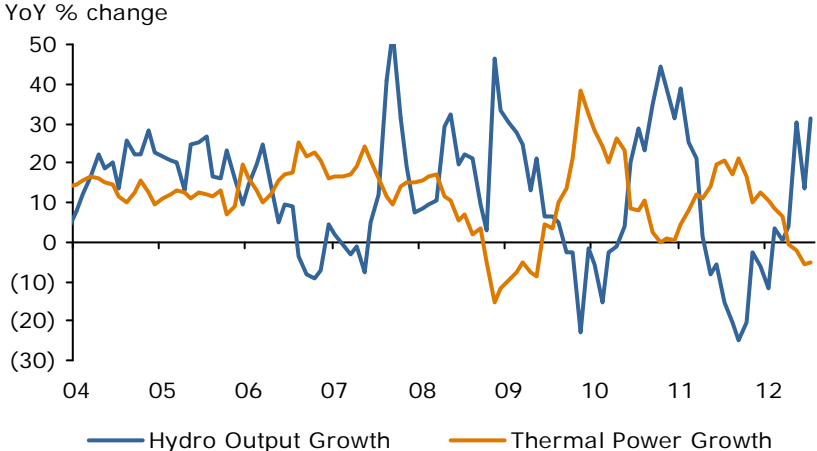
China appears to be producing too much coal compared to its demand

- Recovering hydro capacity is also taking market share away from thermal power, with falling Indonesian coal imports most affected

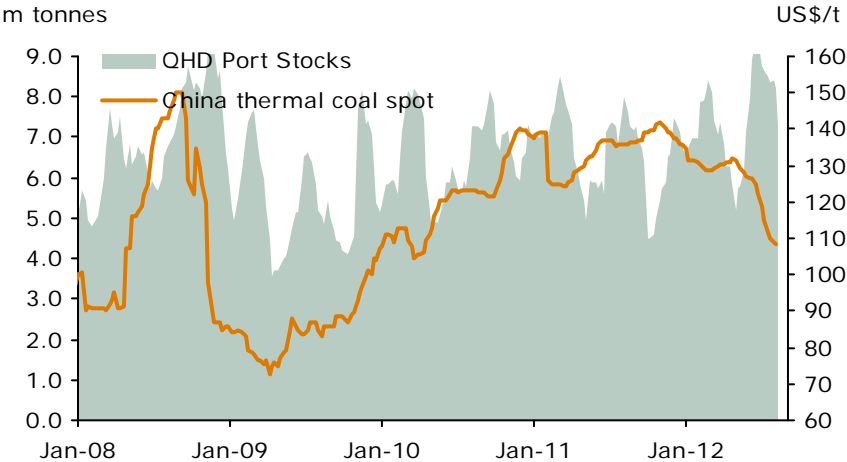
China Thermal Power & Coal Production Growth



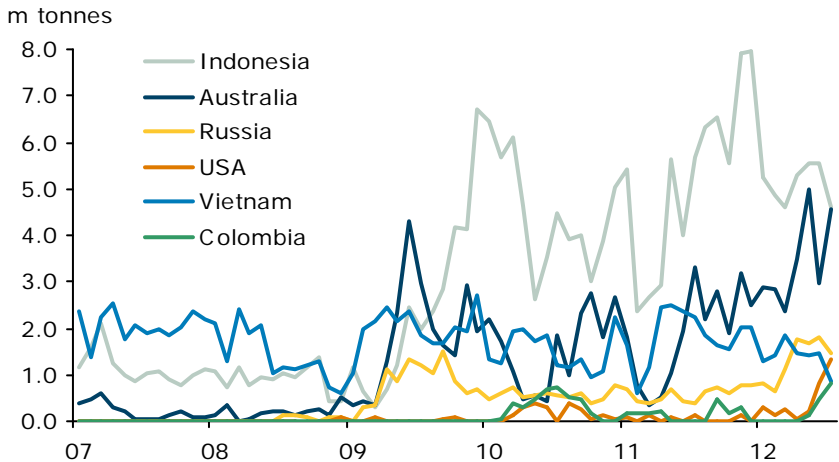
China Thermal Power & Hydro Production Growth



QHD Coal Stockpiles & Domestic Spot Price



Thermal Coal Import Origins

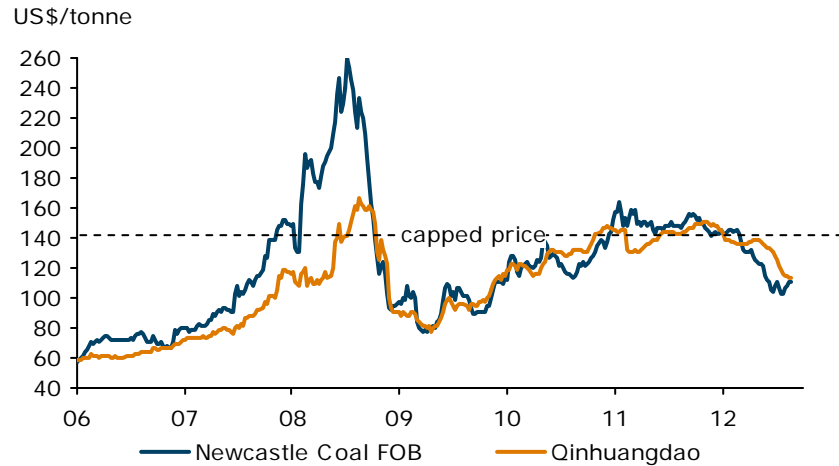


Sources: Bloomberg, ANZ

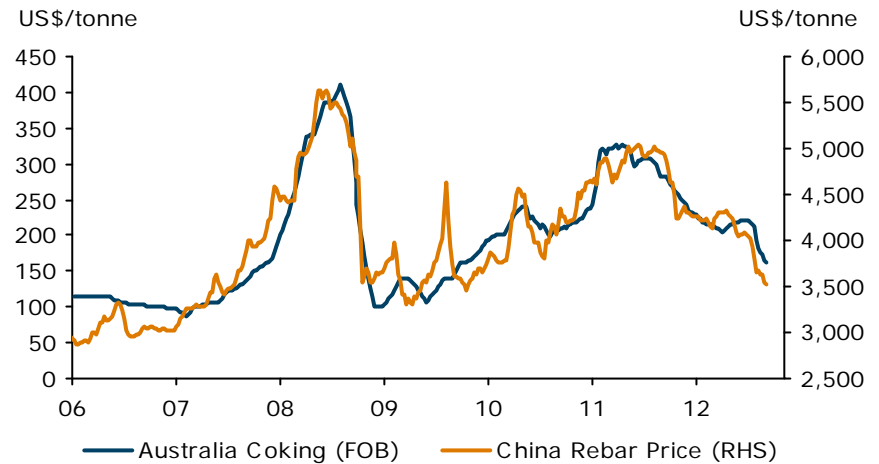


China thermal coal and steel prices remain the key driver of seaborne thermal and coking coal prices – but a floor price appears to have been set in thermal coal as high cost capacity is forced to shut

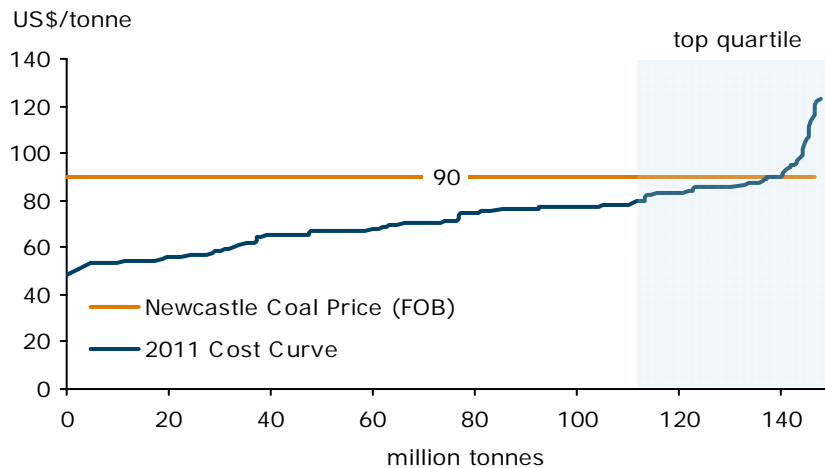
Australia & China Thermal Coal Prices



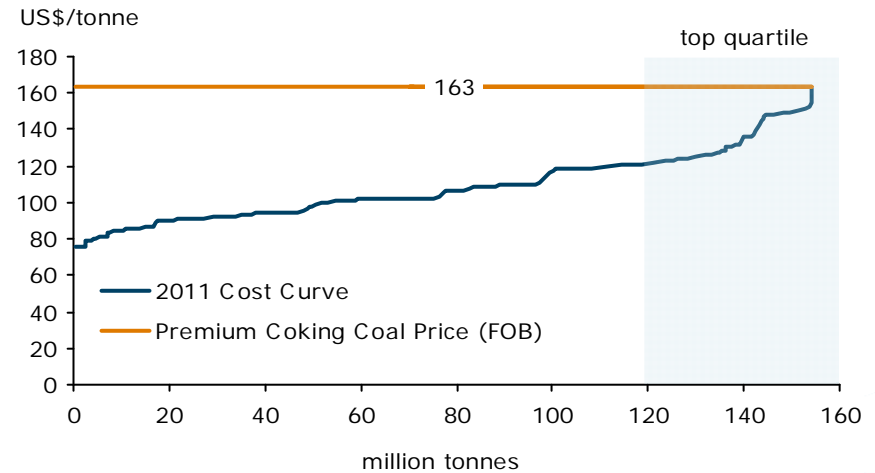
Coking Coal & Steel Prices



Thermal Coal Cost Curve – Energy Adjusted



Coking Coal Cost Curve

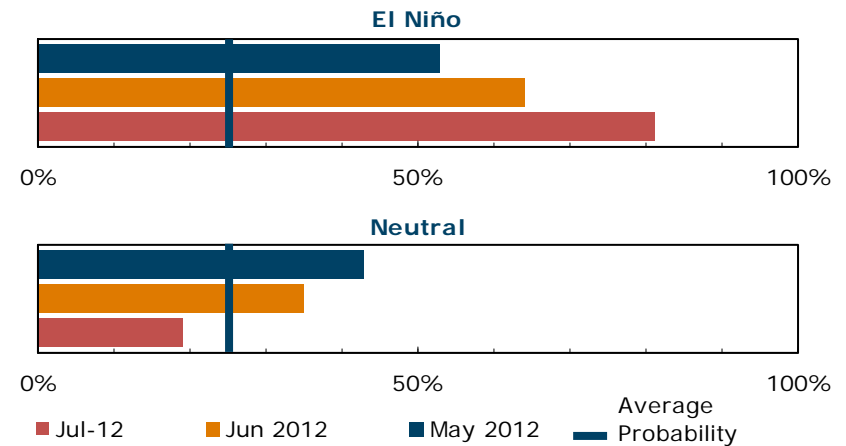


The SOI is starting to flag an El Nino weather pattern – cyclone activity would tend to move eastward into the Pacific, suggesting drier conditions in Queensland

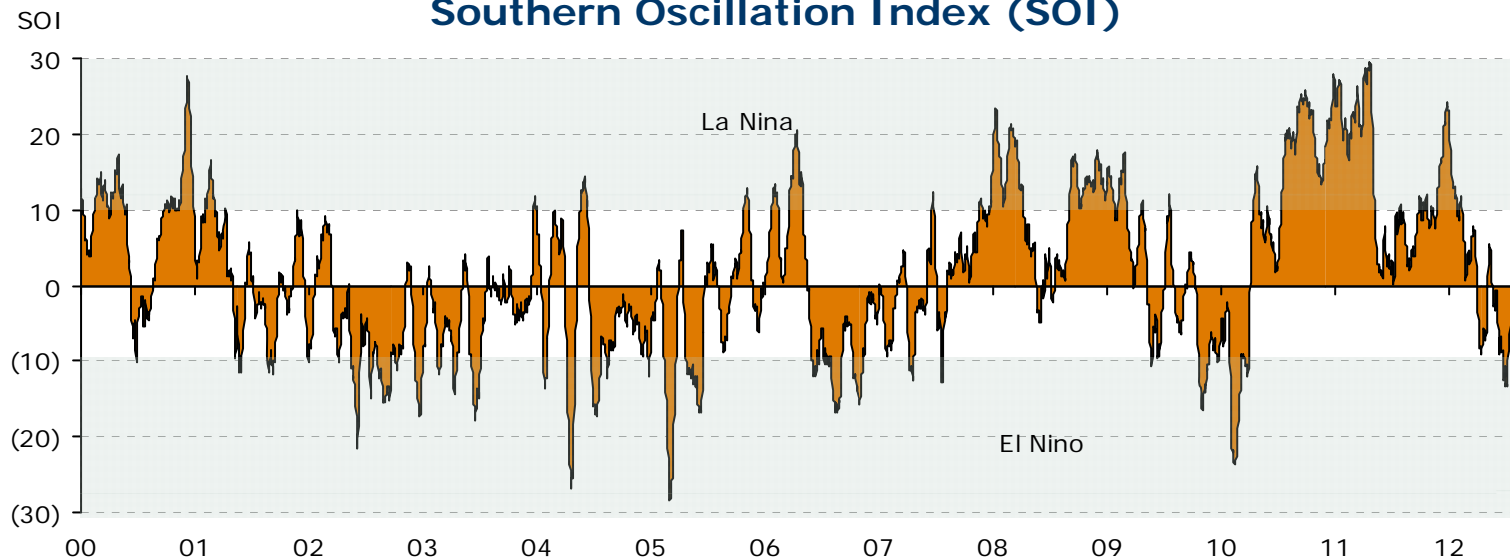
El Nino years



Late Australia Spring 2012 (Q4)

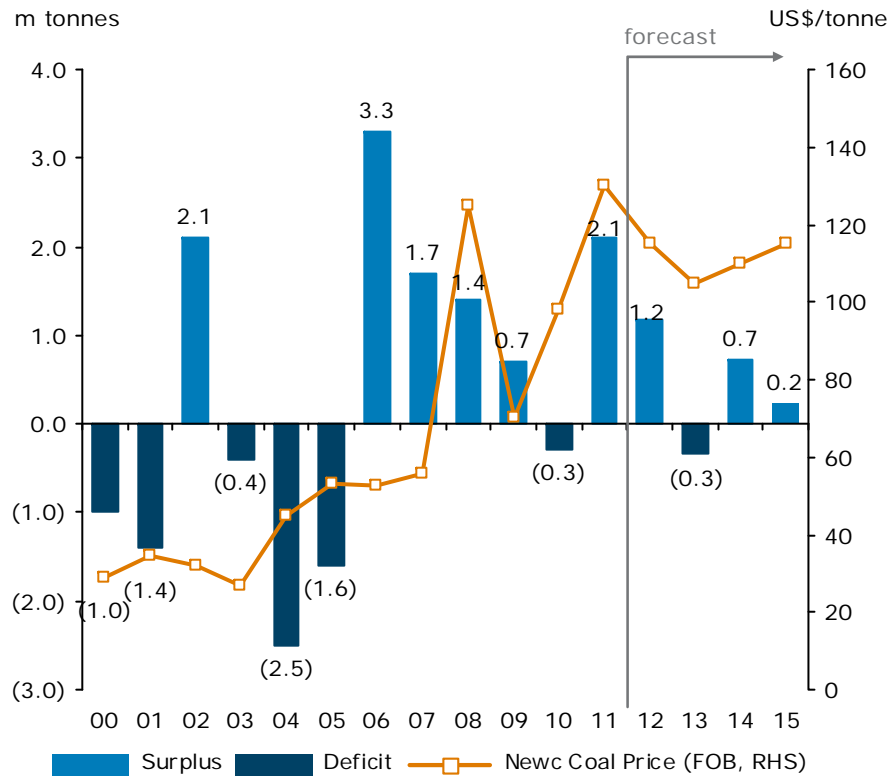


Southern Oscillation Index (SOI)

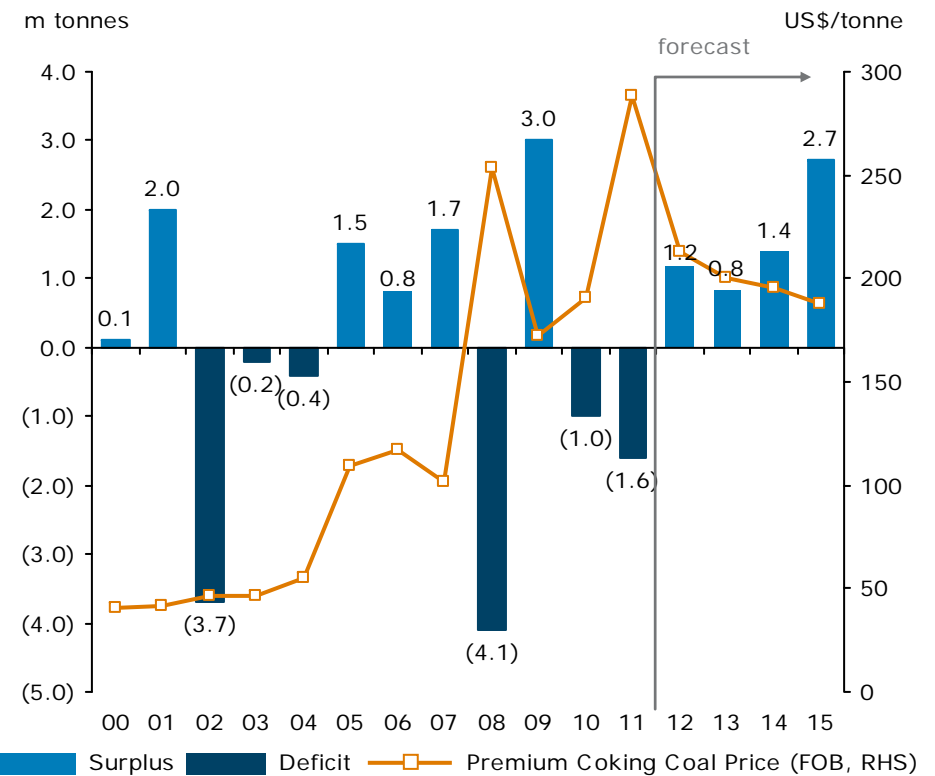


A more meaningful bulk supply response will start to emerge over the next 3-4 years – mainly from Australia (in iron ore) and Mongolia/Mozambique (in coking coal)

Global Thermal Coal Supply Balance



Global Coking Coal Supply Balance



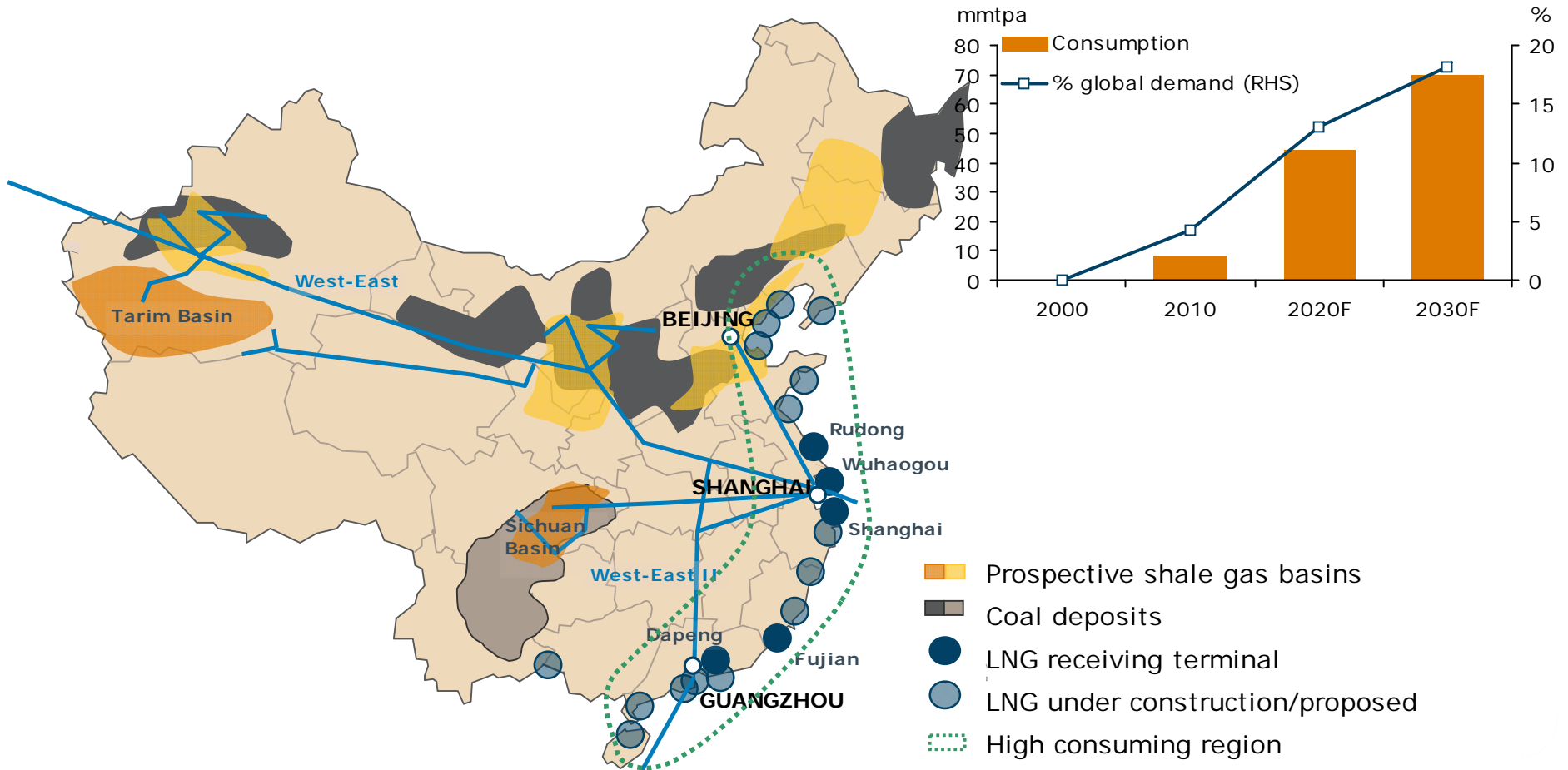
Note: Prices are annual averages
Sources: ANZ, AME, Company Reports



ENERGY

China has doubled its LNG footprint in the past 3 years - having gone from 13 planned, under construction or operating LNG plants to 23. Conventional and non-conventional domestic gas will also be in the developed and blended with LNG

China LNG Developments

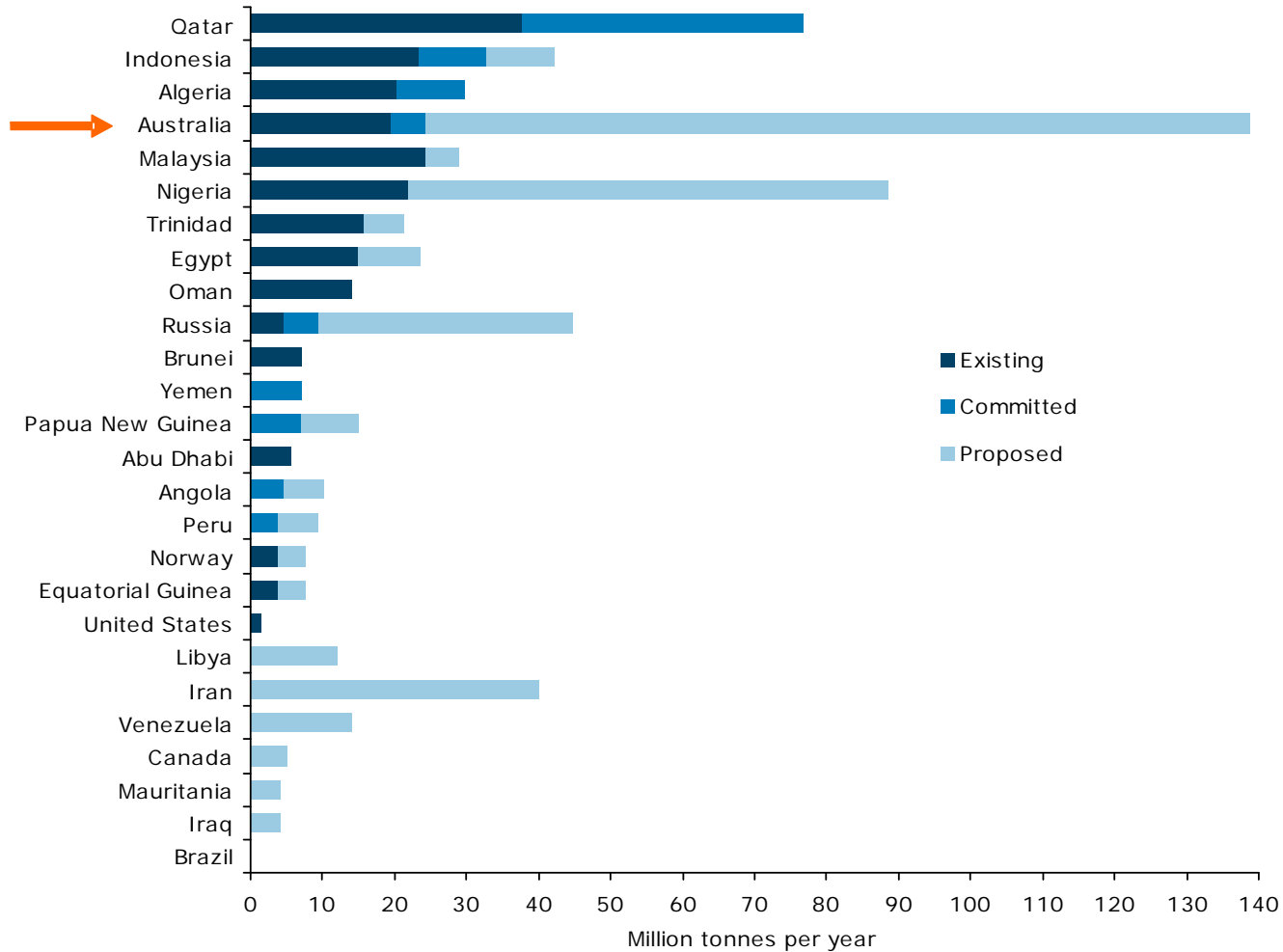


Sources: Wood Mackenzie, ANZ Research

Australia has huge potential in responding with LNG supply 2020

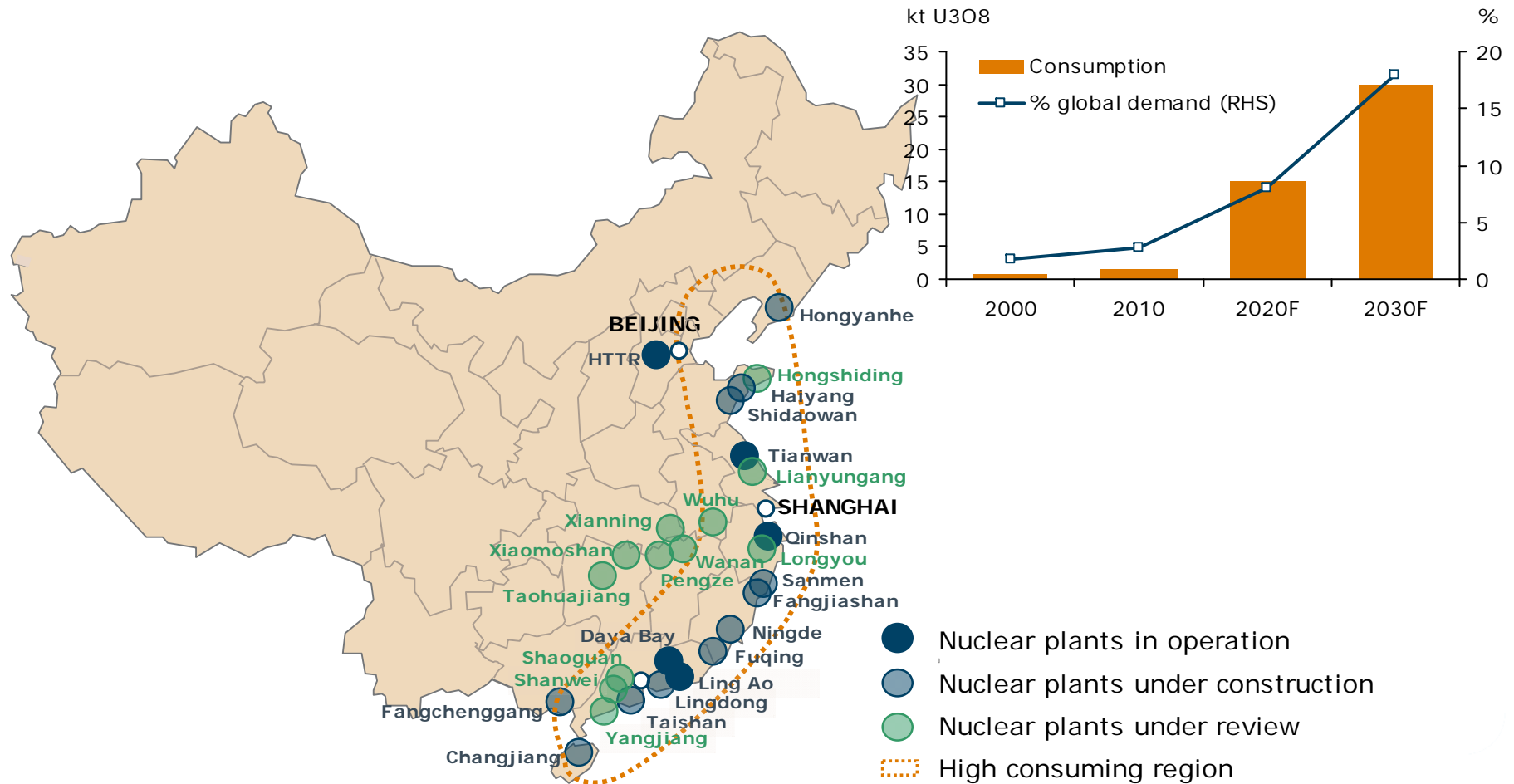
- however, rising Qatar supply will test near term prices

Existing and Proposed Global LNG Supply to 2020



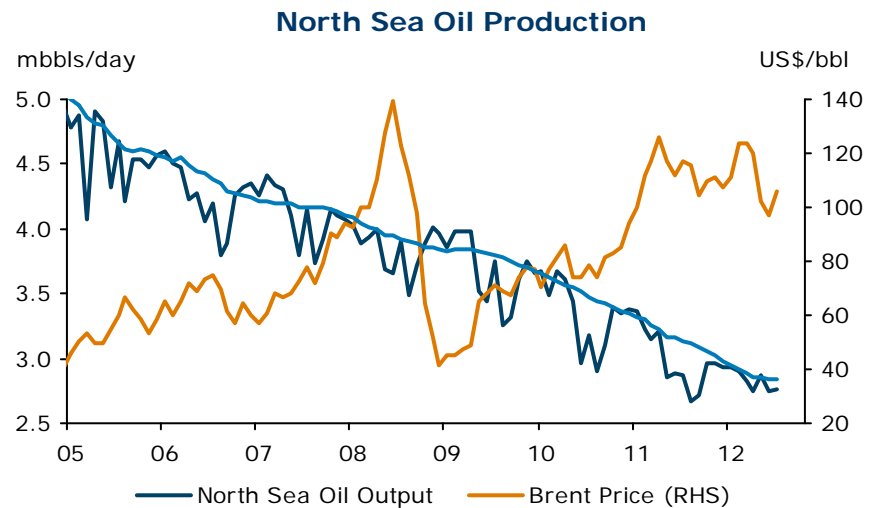
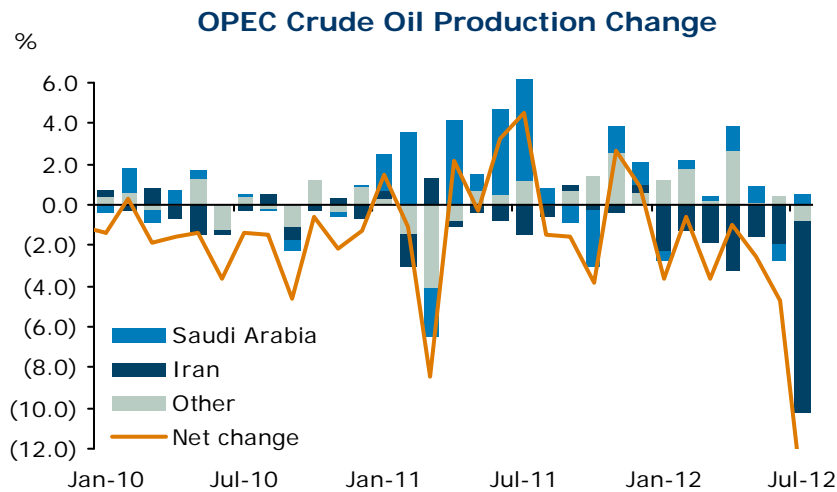
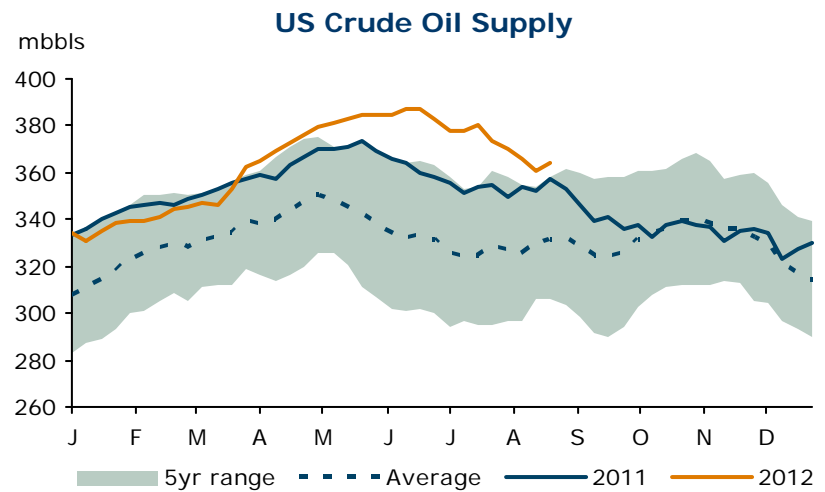
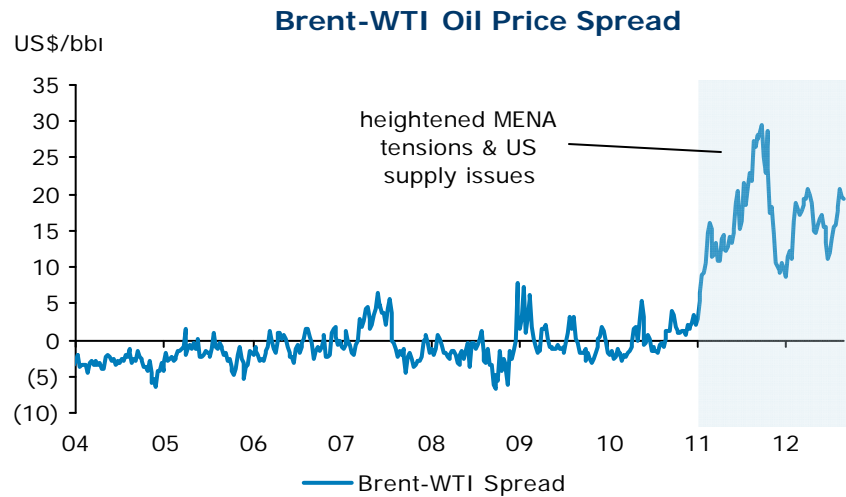
China's nuclear developments back on track after Fukushima – 15 nuclear reactors are in operation, about 80 reactors under construction and planned, while another 150 reactors are being proposed

China Uranium Developments



Note: Each dot represents multiple nuclear reactors on site
Sources: Company reports, ANZ Commodity Strategy

Strong investment fund interest in oil has tightened up the relationship with other risk markets (equities) – heightened MENA tensions is better supporting Brent, while rising US supply is holding back WTI prices



Appendix: ANZ annual commodity price forecasts

End of Period	unit	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F	2018F
Copper	US\$/lb	2.86	3.01	1.38	3.33	4.38	3.44	3.70	3.70	3.20	2.97	2.97	2.97	2.97
Aluminium	US\$/lb	1.28	1.07	0.68	1.00	1.12	0.90	0.91	1.02	0.99	1.02	1.02	1.02	1.02
Lead	US\$/lb	0.77	1.15	0.46	1.09	1.16	0.91	0.98	1.07	1.12	1.11	1.11	1.11	1.11
Nickel	US\$/lb	15.43	11.80	5.27	8.37	11.21	8.49	8.40	9.65	9.15	8.60	8.60	8.60	8.60
Zinc	US\$/lb	1.95	1.07	0.54	1.15	1.11	0.83	0.88	1.05	1.12	1.12	1.12	1.12	1.12
Gold	US\$/oz	635	834	882	1,097	1,421	1,564	1,720	1,740	1,630	1,550	1,550	1,550	1,550
Silver	US\$/oz	12.9	14.8	11.4	16.9	30.9	27.8	31.0	35.3	31.3	30.0	30.0	30.0	30.0
Platinum	US\$/oz	1,118	1,526	935	1,466	1,770	1,401	1,550	1,720	1,665	1,600	1,600	1,600	1,600
WTI Crude	US\$/bbl	61	96	45	79	91	99	98	110	106	99	95	92	92
Dated Brent	US\$/bbl	60	94	42	77	94	108	111	116	110	102	98	95	95
Iron Ore Spot (CIF China)	US\$/t	77	190	72	119	170	139	112	135	125	120	115	100	95
Iron Ore Contract (FOB Aust)	US\$/t	47	51	92	60	129	167	109	126	115	107	102	125	119
Premium Coking Coal	US\$/t	114	98	305	128	210	285	180	205	190	185	180	180	180
Newc Thermal Coal (Spot)	US\$/t	52	90	81	86	129	114	90	106	113	115	111	105	100
Newc Thermal Coal (JPY Contra)	US\$/t	53	56	125	70	98	130	115	105	110	115	110	105	100
A\$/US\$	US\$	0.79	1.07	0.69	0.90	1.02	1.02	1.02	1.07	0.94	0.78	0.78	0.78	0.78
Average	unit	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F	2018F
Copper	US\$/lb	3.06	3.24	3.16	2.34	3.43	4.00	3.70	3.95	3.53	3.07	2.91	2.80	2.79
Aluminium	US\$/lb	1.17	1.20	1.17	0.76	0.99	1.09	0.91	0.99	1.00	1.00	1.03	1.05	1.05
Lead	US\$/lb	0.58	1.17	0.95	0.78	0.97	1.09	0.91	1.04	1.09	1.11	1.09	1.05	1.00
Nickel	US\$/lb	10.96	16.87	9.58	6.65	9.91	10.39	8.15	9.26	9.45	8.92	8.29	8.04	8.00
Zinc	US\$/lb	1.48	1.48	0.85	0.75	0.98	1.00	0.88	0.99	1.08	1.12	1.11	1.07	1.04
Gold	US\$/oz	604	697	873	973	1,226	1,571	1,660	1,783	1,666	1,598	1,489	1,372	1,351
Silver	US\$/oz	11.6	13.4	15.0	14.7	20.2	35.2	30.1	33.9	33.7	30.6	28.4	26.0	26.0
Platinum	US\$/oz	1,142	1,305	1,577	1,208	1,613	1,721	1,527	1,666	1,691	1,634	1,553	1,484	1,451
WTI Crude	US\$/bbl	66	72	100	63	79	95	95	107	109	102	95	92	92
Dated Brent	US\$/bbl	65	73	98	63	80	111	110	116	114	105	98	95	95
Iron Ore Spot (CIF China)	US\$/t	71	125	158	80	147	168	128	124	131	122	114	95	90
Iron Ore Contract (FOB Aust)	US\$/t	45	50	81	68	114	164	119	122	119	110	102	118	125
Premium Coking Coal	US\$/t	117	102	253	172	191	289	213	200	195	188	181	178	175
Newc Thermal Coal (Spot)	US\$/t	49	66	129	71	99	121	96	100	109	115	111	104	100
Newc Thermal Coal (JPY Contra)	US\$/t	53	55	108	84	91	122	119	108	109	115	111	106	100
A\$/US\$	US\$	0.75	0.84	0.85	0.79	0.92	1.03	1.03	1.06	1.01	0.86	0.81	0.80	0.79

Source: Bloomberg, ANZ Commodity Strategy

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