Slow September with ‘spikes’ smoothening

- Pairing back gains made over late summer period, commodity prices slowed as unprecedented “spike” in high frequency industrial and trade indicators normalized, while the ramifications of global COVID-19 restrictions imposed (in some cases re-imposed) on employment persist in pulling commodity markets lower (TRJ Index down 4.7%MoM, -21.4% CYTD)

- Continued contraction in industrial output in major emerging markets (India, Brazil) and EU countries fed into weak energy price dynamics, with crude benchmarks pairing back minor supply linked gains made in Aug'20 during the month (Brent/Arab Light price fell 11/14%MoM) whereas Coal jumped on buying interest from China and tight supply

- Amongst major commodity classes, soft commodities including Cotton, FAO food price index and related agri-chemicals continued to climb higher, largely from trade tensions, supply constraints in emerging markets and follow-on impacts on farming supply chains from COVID-19 closures.

- At home, a contained international commodity prices scenario plays into tamed external/trade expectations. Despite this, increasing food prices continue to instigate inflation, in-turn hurting disposable incomes. Possible lessons to be learnt here from international commodity markets include shocks from COVID-19 disruptions on internal agri-supply chains, resulting in increased reliance on imports pushing prices higher.

Crude responds to shocks, fading supply discipline: Crude oil benchmarks slipped during Sept’20, where the month saw large swings in supply dynamics from major producers, while US President Trumps COVID positive diagnosis left markets rattled. Continued contraction in industrial output in major emerging markets (India, Brazil) and EU countries fed into weak energy price dynamics, with crude benchmarks pairing back minor supply linked gains made in Aug’20 during the month (Brent/Arab Light price fell 11/14%MoM). That said, support was provided by major shut-ins in the expectation of hurricane season starting in the US Gulf Coast and Norway reducing production due to worker strikes. A major factor supporting crude prices throughout the month was reports that Saudi Arabia may look to hold off the OPEC+ agreement plan to cut production limits by another 2mn bpd through to 1st Jan’21, citing continued growth in COVID-19 cases globally, necessitating production curbs for till at least CY21. Presently, the OPEC Joint Monitoring Committee meeting takes place on 16th October with KSA likely to continue enforcing its hardline stance on countries meeting their promised compensation cuts (in-line with Aramco raising Nov’20 crude shipment prices).
Rebound in coal prices as economies start to come back online  After remaining range-bound for last few months as COVID-19 related restrictions kept economic activity muted, coal prices witnessed a strong Sep’20 as activity emerged from two largest demand centers i.e. India and China and resultantly, prices increased by 4%MoM to average at US$57.5/ton for Sep’20 and currently trade around US$60.7/ton. Buyers from China, with some import quota left, participated in the market while additional stimulus was provided by India where imports of coal increased to 14.6mn tons in Sep 20 against 13.0mn tons for Aug’20. Moving forward, uncertainty over China’s import policy remains and the same can be witnessed in coal prices in near term with prices treading sideways however increasing economic activity in India and in other parts around the globe can prove to be a catalyst for further price increase. With margins for local players already low, we expect increasing coal prices to result in increased prices of local cement as players look to pass on the impact. However, in case prices are not increased in near term, as per our estimates, PIOC (being the most sensitive) will be the worst affected while MLCF stands on the other end of the spectrum.

Fertilizer prices on an aggressive uptrend: The urea price in Sep’20 continued their uptrend, rising 4% MoM and 17% FYTD to US$252/MT, with a reversal in global demand and energy prices from their early CY20 lows. In local context, the international urea price translates into Pkr2,780/bag, at a 74% premium to current local prices, leaving a wide margin for the Fertilizer players to increase urea price in case of no relaxation given on GIDC payment timeline and schedule (EFERT already increased Pkr25/bag in terms of urea price w.e.f 10th Aug’20). To recall, Supreme Court directed complete recovery of GIDC dues from the industrials within next 24 months, w.e.f Aug’20. However, the Fertilizer players have demanded an extension of 8 more years to repay the GIDC dues, indicating a potential urea price increase in case of dismissal of request. In similar vein, DAP price are also on the route of a comeback, rising 3% MoM and 26% CYTD to US$340/MT, while prices from China are at US$360/MT, with the later translating into local DAP price of Pkr3,900/bag. With the onset of Rabi season, the local DAP players have cumulatively increased price by Pkr500/bag to Pkr3,900/bag, as per our channel checks, with room for further price hikes.

Steel witnesses mix trend: After rising for consecutive 4-months, steel prices have taken some respite in Sep’20, with the mixed trend witnessed across the different segments. In long steel, prices saw a divergent trend, with final product prices (i.e rebar) slightly coming off (-0.5%MoM) while billet prices marginally rising (+0.4%MoM). Consequently, rebar-billet spread further narrowed 13%MoM to a multi-year low of US$31 per ton. Flat steel also witnessed a mixed trend, however, contrary to long steel. In flat steel, CRC prices jumped 3.74%MoM while HRC recorded a monthly decline of 0.82%MoM, translating into a 41%MoM increase in the primary spread between CRC-HRC.

Cotton sustains uptrend in Sep’20: Cotton maintained its upward momentum during Sep’20, with international cotton prices increasing by 1%MoM to USc70.75 per lbs. The latest USDA report featured small declines to global estimates for MY21 production (-326k bales to 117.2 million) and mill-use (-366k bales to 112.7 million), however, a larger revision to global production for MY20 (-1mn bales) led to lower ending stocks (-1.1mn bales to 103.8mn bales), providing critical support to international prices. Domestic prices observed steep increase of 4.5%MoM on the fears of damage to crop following torrential rains during the monsoon. In terms of price outlook, the US is reportedly considering a ban on imports of textiles containing cotton from Xinjiang province. Note that the Xinjiang produces 90% of the country’s total cotton output. While the potential implications of the ban on demand and supply are unclear yet, the potential cost increases associated with the movement of supply chains as well as general uncertainty could weigh on cotton in the short-medium term.
**Food prices indicate undersupply as the driving force:** FAO food price index reached its highest value since Feb’20 and represent fourth consecutive monthly increase, averaging 97.9pts in Sep’20 (+2.1%MoM/5.0%YoY). Firmer prices of Vegetable Oils (+6.0%MoM to 104.6pts) and Cereals (+5.1%MoM to 104.0pts) were behind the latest rise in the index. Vegetable Oil Index marked 8th month high as a result of rising palm, sunflower seed and soy oil prices. International palm oil prices rose markedly for 4th consecutive month, tied to fresh global import demand, lower than expected inventory levels in Malaysia, and uncertainties regarding future production outlook. FAO Dairy Index remained flat MoM to avg. at 102.2pts as moderate increases in prices of butter, cheese and skim milk powder (SMP) were offset by a fall in prices of whole milk powder (WMP). On the other hand, FAO Meat Index was down 0.9%MoM to avg. at 91.6pts in Sep’20, continuing the general declining trend observed since Jan’20 despite the increase in poultry meat prices that is underpinned by the fast pace of international sales and limited exportable supplies from Brazil. Overall, we believe the outgoing month is Neutral to Negative for the Food listed space.
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