

COMMODITIES
UPDATEREP-019
MARKET
VISTA

Trade tensions take their toll

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- Persistent risks over global trade policy, heightening fears over emerging market volatility and deepening tensions in the Middle East crept into commodity prices, where the Thomson Reuters commodity index stayed flat on MoM basis.
- US President Donald Trump moved ahead with increasing tariffs on further US\$200bn of imports from China as escalating retaliatory measures have come at a tough time for emerging markets generally, where heightened tensions could pull down global growth, as WTO cites in its downgrade of global trade outlook.
- Despite dampeners to global economic growth, energy commodities climbed higher, with Brent/Arab Light rising 7.2/5.9%MoM as the market accommodated reduced supply from Iran and consistent growth in the US, while oil majors remain slow to ramp-up supply.
- Coal prices came-off highs remaining above the US\$99/ton mark for the month, as supply curbs continued; and while steel benchmarks remained firm, the widening CRC-HRC spread alludes to falling demand from emerging market heavyweights China and Turkey.
- Concerns over a supply glut from slower demand due to trade tensions pulled cotton and FAO food price indices down by 4.6/1.4%MoM, where the Dairy price index fell 2.4% MoM, pulled lower by expectations of higher supply.

It's Trump all the way: Oil benchmarks went uphill for yet another month, centered around news flows of 1) Trump imposing tariffs on US\$200bn worth of goods from China and 2) events in the run up to Iran sanctions. As a result, WTI/Brent/Arab light rose 3.30/7.20/5.99%MoM on average to close at US\$73.3/79.1/78.7/bbl. During the first few trading days of Sep'18, prices lost steam as speculators factored in fears of a full-fledged trade war slowing global growth, along with US exports data reflecting China's reduced upliftment of crude from the US. However, falling US crude inventories (down 1.83mnbbls in Sep'18) injected strength later during the month, furthered by comments from Iranian officials that Russia and Saudi Arabia lacked capacity to fill the vacuum created by loss of exports from Iran. All this happened in spite of Trump's warning to OPEC to keep prices in check during his address at the UN General Assembly. Local oil proxy Arab Light peaked at US\$82.63/bbl on Sep 26'18, its highest since Nov 3'18. On the domestic front, refining margins remained depressed where MOGAS spreads were down by 70% as compared with average spreads since Jan'17 on the back of reduced demand as prices of refined products elevate globally. Moving ahead, as the date to Iran sanctions draws closer, further bullish bets on oil prices can't be ruled out.

Coal price corrected 1.6% in Sept'18: After touching its seven-year highs in Jul'18 (US\$109.1/ton), thermal coal prices have corrected 8.9% since then to average at US\$99.3/ton in Sep'18 (down 1.6%MoM). Traditionally, demand for thermal coal tends to be weak between August and September before early winter demand kicks-in for the heating season. Maintaining such high levels, the heating commodity is still up 12.5%YoY to currently stand at US\$101.5/ton owing to 1) strong demand from China and India, 2) output curbs in major supplier: China (crackdown on local mining) and 3) record European/Asian heat wave.

Cotton retreat 4.6%/10%MoM: Ongoing trade dispute between China and US – particularly China's decision to impose the duty on cotton import from the US – continued to weigh on international cotton prices in Sep'18, with benchmark 'COTLOOK A' index retreating 4.6%MoM to average out at US\$90.21/lbs. Domestic prices mirrored the moves in international trends, declining 10%MoM on average. Latest USDA's estimates indicate a substantial increase in world production (+1.5mn bales to 122mn bales) and a marginal uptick in world consumption (+0.3mn bales to 127.9mn bales), leaving higher global ending stocks (+0.4mn bales) compared to last month. Looking ahead, cotton price direction is largely dependent upon China's decision to im-

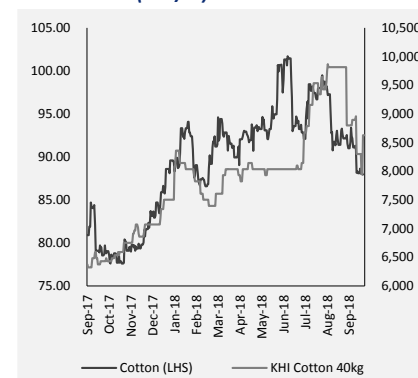
Brent (US\$/bbl)



COAL Price (US\$/MT)



Cotton Prices (USc/lb)



Source: KCA, Bloomberg & AKD Research



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port cotton to restore its inventory level (now standing at a multi-year low of 6.6mn tons).

Urea price continues to rise: After gaining 3%MoM in Aug'18, int'l urea price further moved up 6%MoM to average US\$311/ton (Middle East Granular) in Sep'18. Building on recent gains, global urea market remains very strong compared to a year ago, where the prices are almost up 16% YoY to currently stand at US\$320/ton (gained 36% since May'18). Lower supply from China (exports: down 74%YoY), sanctions against Iran and increased energy cost (particularly for producers in Europe and China), have significantly increased the production cost of manufacturers, which consequently translated into higher final product prices. Going forward, int'l urea prices are expected to remain on the higher side in the remaining part of 2018 as global supply and demand balance will tighten further, with net global urea supply growth expected to be well below the historical demand annual growth rate of a ~2%. To note, the sharp rise in global prices coupled with currency depreciation has further widened the differential between local and int'l urea prices (34-36% discount to prevailing landed cost of Pkr2,580/bag).

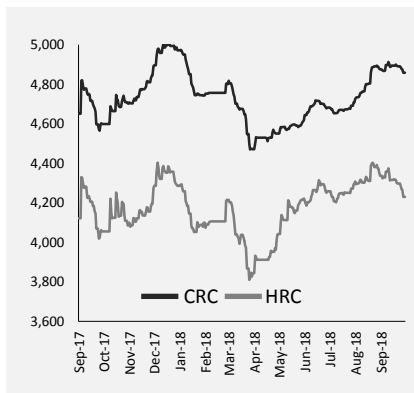
Steel witness mixed trend in Sep'18: Despite demand weakness in major countries (i.e. China & Turkey), steel prices remained firm at elevated levels in Sep'18 (CRC/HRC averaged at US\$713/629 per ton, +1.51%/-0.59%MoM). Interestingly, diverging movement in prices widened the CRC-HRC spread to US\$84 per ton (vs. US\$70 per ton in the last month). With steel prices at 5-yr high level, demand slowdown in key markets could weigh on prices in the near term. Moreover, the current wave of protectionism could add to downward pressures on steel prices.

Food index down 1.4%MoM: Maintaining the downward trajectory, FAO food price index in Sep'18 further went down 1.4%MoM to average at 165.4pts. While demand remains strong, ample supply of major food commodities kept prices under check. Amongst major constituents, sugar index was notable exception, with index moving up 2.6% MoM to stand at 161.4pts on account of lower than expected crop from Brazil (largest exporter of sugar). Vegetable oil price index reached a three-year low at 134.9pts (down 2.3%MoM), with palm oil registering sharpest decline due to buildup of large inventories in major exporting countries along with arrival of new crop supplies in Black Sea region.

Urea Middle East Granular (US\$MT)

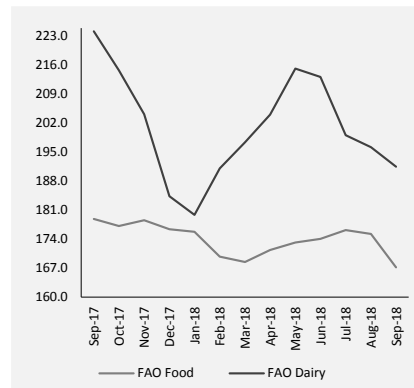


Steel price (CNY/MT)



Source: Bloomberg & AKD Research

FAO Index



Source: FOA & AKD Research

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Neutral	> 10% to < 16% expected total return
Sell	< 10% expected total return (Rf: 10%)

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Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

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- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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