

# COMMODITIES UPDATE

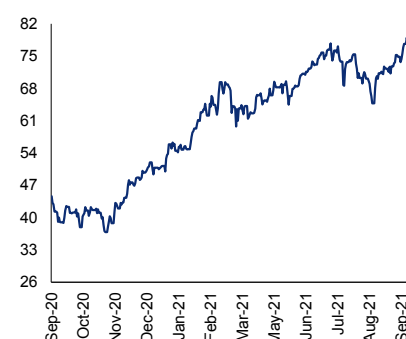
# REP-019 MARKET VISTA

## Global Commodities reflecting signs of flattening

- Global commodities measured by TRJ Commodity Index has gained 4.9%MoM during Sep'21. However, a more important trend is emerging with the outgoing quarter marking the slowest increase in Commodity prices (Ex-Energy) over the past 3Qs (in percentage and in absolute terms) with TRJ Commodity Index and Bloomberg Grain Index reporting a change of +7.5%QoQ and -ve 3.3%QoQ, respectively, indicating that the curve could be flattening.
- This can also be verified by downtick in Baltic Sea Freight Index (down 4.8% from peak values), which has been an important lead indicator signaling turning points in commodities historically with statistical p-value near zero. Lastly, Saudi Arabia has cut oil prices for Asian deliveries by US\$1-1.5/bbl citing demand flattening in these economies.
- The potential ease-off in key commodities casts positive overtures on macro front (Base case FY22 CAD estimated at US\$11.6bn) where slowdown in price accumulation in major food commodities, (FAO: +2.2%QoQ – the slowest in past 5Qs) with Grains already undergoing correction, (down 3.3%QoQ) should moderate inflationary pressure in the coming months (FY22E: 8.7%YoY).
- The market has corrected 7.3% since the beginning of this fiscal year, turning valuations attractive in our view. We advocate of building positions taking a medium term view, betting on successful conclusion of IMF review moderating uncertainty on macro front. We like Banks as SBP in line with global Central Banks roll back monetary relaxations, Techs (perfectly hedged against commodity and macro risks), and Cements/Steel & Construction-Allied (commodity risks priced-in to valuations).

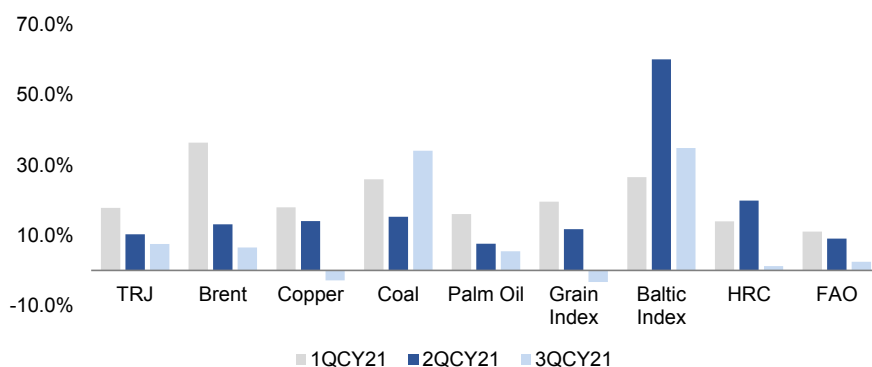
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Brent (US\$/bbl)



Source: Bloomberg & AKD Research

### Commodity curve flattening



Source: Bloomberg & AKD Research

**Coal prices continue the upward march:** Coal prices have been soaring as energy crunch around the world has resulted in energy commodities going through an upcycle. It all started with rebound in global demand as electricity demand increased in developed countries while natural gas/LNG supply could not keep pace, resulting in power production shifting towards coal. The increase has intensified as we approach winter season as prices in 3QCY21 increase by 34.1% on QoQ basis against 15.2% in preceding quarter. Fuel to the fire was added by increased buying from China which had earlier released inventory from its coal reserves to stabilize local coal prices. Moving forward, efforts are underway to curtail the increase in coal prices with China asking its local mines to increase output while recent news items suggest supplies have been procured for the winter season. To note, China's coal imports surged 76% in September. This



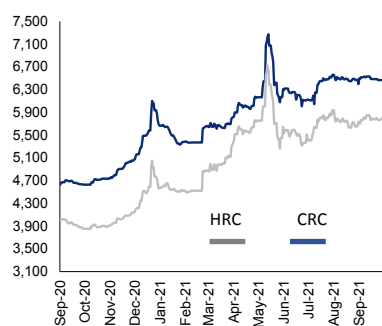
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coupled with decrease in demand in developed economies post winter will result in coal prices abating, in our view. The aforementioned decrease will be a relief for local cement manufacturers after they have struggled to pass on the impact of increase in coal costs where despite the recent increase of PKR50/bag. If coal prices remain around USD200/ton for remainder of FY22, another PKR80-90/bag will need to be increased in order to fully pass on the cost.

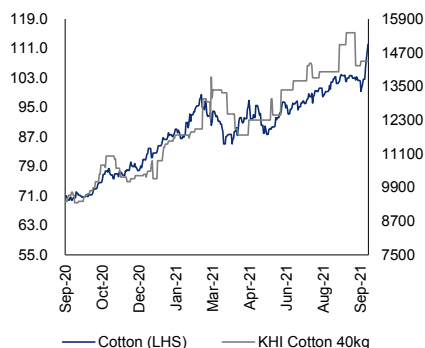
**DAP prices have averaged at US\$660/MT in Sep'21**, flattish on MoM basis, but up 94%YoY on the back of global crunch in phosphates market. This translates into local landed cost of PKR6,815/bag. Following the start of CY21, the DAP markets tightened due to supply chain issues, resulting in lower production in the western hemisphere while the occurrence of natural disasters (hurricane IDA), surging coal prices and China's imposition of export restrictions to meet the local demand have soared the international DAP prices to US\$660/ton, swelling by 70% CYTD. Going forward, we expect the international DAP prices to hover in the range of US\$700/ton in 4QCY21 on account of inflated energy costs and higher freight charges, however, as the global commodity bull cycle loses heat and supply from middle east resumes, we expect the international DAP prices to ease off to 550-600US\$/ton in CY22. On the other hand, local Urea prices stand currently at PKR1,768/bag, a discount of ~70% from international markets and expected to be anchored to local dynamics.

**International scrap prices down 3.5%MoM in Sep'21:** International scrap/copper prices have decreased by 3.5%/1.0%MoM in Sep'21 to currently hover around US\$483/9660/ton compared to last 3 months avg. of US\$493/9407/ton as global demand relaxes with economic activity halting on the back of enormous shortage of electricity in world's leading manufacturing nations amid floods, other weather disruptions and Evergrande fallout. Conversely, scrap/copper prices have started to turn north with an increase of 7.6/8.0% since the start of Oct'21, amid short-term supply concerns. Moving forward, in the medium term, metal prices should remain in check where concerns about China's economy weighs heavy. On the local front, rebar prices have remained flat in the month of Sep'21 to stand at 179-180K/tons, following 14%MoM increase in Aug'21. Moreover, the news concerning slashing duties on scrap is gaining momentum but Govt. is yet to confirm or give any clarity on it. Currently, 5%/2% regulatory/additional custom duties are imposed on imported scrap. However, we believe any benefit associated with the removal of duties will be passed on, resulting in the reduction of local rebar prices.

### Steel price (CNY/MT)



### Cotton Price (Usc/lb)

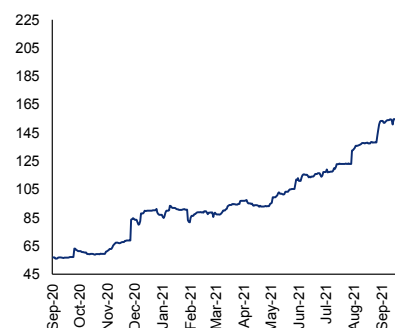


Source: Karachi Cotton Index, Bloomberg & AKD Research

**Cotton prices to remain elevated in the short term:** International cotton prices remained strong throughout 1QFY22, hovering around US\$119/lb with an increase of 10%QoQ in 1QFY22 and cumulative CYTD increase of 40.3%. Going forward, we expect prices to remain elevated in the short run where global consumption (est. +3.1% in 2022) is likely to be balanced by production (est. +5.6% in 2022) as per USDA report. However, in the event of demand normalization together with higher inventory of cotton as at FY22-end of 87.2mn bales (vs. 74.2mn bales avg. of last decade) should translate into prices retreating in the medium run. Local cotton prices have remained elevated, up 4% since start of Oct'21 to currently hover around PKR14,939/maund and up 9%QoQ in 1QFY22. From Pakistan's perspective, initial numbers released by the Govt. cast positive overtures regarding production levels where FY22 cotton output is estimated at 9.8mn bales whereas, mill use is expected to be at 12-13 mn bales.

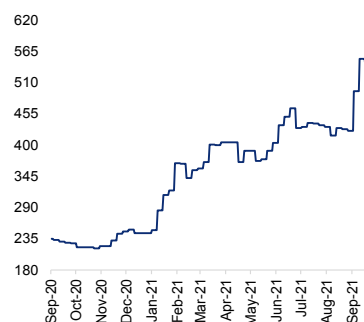
**FAO Food Price index, +1.2%MoM:** FAO Food Price Index averaged at 130pts in Sep'21, +1.2% MoM and 32.8%YoY where the latest increase is largely driven by higher prices of most cereals and vegetable oils while other contributors remained stable. FAO Vegetable Oil Price Index was +1.7%MoM driven by increase in palm oil prices while soy and sunflower prices declined. Palm Oil prices continue to reel from robust global demand that coincided with concerns over below-potential production in Malaysia due to persistent labor shortages. FAO Dairy Price Index was

### Coal Price (US\$/MT)



Source: Bloomberg & AKD Research

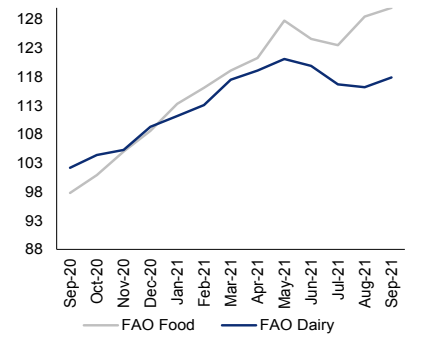
### Urea Middle East Granular (US\$/MT)



Source: Bloomberg & AKD Research

+1.5%MoM where jump in SMP and butter prices at the back of strong demand in Europe amid limited export availabilities. FAO Meat Price Index remained flat during the month where uptick in bovine and ovine meat prices were offset by normalization in supply of poultry meat pushing down prices.

### FAO Index



Source: FAO & AKD Research

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To arrive at our period end target prices, AKDS uses different valuation techniques including:

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

### New Rating Definitions

<b>Buy</b>	> 14.5% expected total return (Rf: 8.5% + Rp: 6%)
<b>Neutral</b>	> 8.5% to < 14.5% expected total return
<b>Sell</b>	< 8.5% expected total return (Rf: 8.5%)

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