The Commodities Feed: The power crunch spreads to the rest of the complex

Your daily roundup of commodity news and ING views

Energy

The oil market has started the week on a strong footing. ICE Brent continues to edge higher in early morning trading in Asia and it seems as though it is only a matter of time before the market tests the US$80/bbl level. Broader concern over tightness in energy markets, particularly for natural gas, is spilling over into the oil market. The Asian LNG market is trading at an equivalent of over US$150/bbl, while European gas prices are not too far off an equivalent of US$140/bbl. These higher gas prices will lead to some gas to oil switching, which would be supportive of oil demand. This stronger demand coupled with supply losses in excess of 30MMbbls from the US Gulf of Mexico (due to Hurricane Ida) suggest a tighter than expected market.

It will be interesting to see what OPEC+ have to say about the strength in energy markets when they meet on 4 October. In the current environment, it seems almost certain that the group will continue to ease supply cuts, which should see them confirm at least a 400Mbbls/d supply increase for November. We would not rule out OPEC+ deciding to ease by more than this amount, particularly if the current strength in the market persists. The group will likely face growing pressure from some key consumers if prices continue to trend higher.

The latest rig count data from Baker Hughes shows that the US industry increased the number of active rigs by 10 over the last week, taking the total count to 421. This is the highest level since April last year. While the rig count has grown by 58% so far this year, it is still well below the 683 active oil rigs seen in March last year. However, the current price environment should see the count continue to trend higher, supporting supply growth for next year and going into 2023. The EIA estimates US supply growth of a little more than 640Mbbls/d in 2022.

The positive sentiment we are currently seeing in the market is reflected in positioning data. The latest Commitment of Traders report shows that speculators increased their net long in ICE Brent by 21,004 lots over the last reporting week, leaving them with a net long of 319,651 lots as of last Tuesday. This is the largest position they have held in the market since March. Given that the oil price has strengthened further since last Tuesday, the speculative position today is probably is even larger.

Metals

The power crunch and supply woes are dominating the metals complex. The power shortage in China continues to escalate and hit producers along the supply chain disproportionally. While things are continuing to unfold, the power issue acts as a double-edged sword, hitting smelter production and leading to reduced supply. This is positive for metals prices. However, it is also affecting semi-fabricating and downstream consumers, which is negative for prices. In Anhui, the latest power rationing program has hit semi-fabricators harder than cathode production according to MyMetal.

The rally in aluminium took a breather last Friday, possibly due to a steady rise in inventories in the China onshore market. As for stocks, these are generally expected to build following the seasonal trend. However, onshore copper stocks have continued to edge lower, hitting their lowest levels since 2009. Reduced scrap flow continues to propel consumers to buy cathode instead. According to the latest data from customs, China's scrap imports fell by 13% MoM in August.

As for zinc, LME prices have surged after high energy prices in Europe hit zinc production at one of Nyrstar's zinc smelters based in the Netherlands. There are also rising expectations on a tighter concentrate market as Northern China-based mines will slow down operations over the winter, while smelters start to build up feedstock inventory. The tightness in the concentrate market has been one of the themes that has bolstered the zinc market. However, there is also growing concern that downstream zinc consumers may be hit hard by the ongoing power crunch, which could weigh on demand.

Agriculture

In China, soybean processing plants in several regions, including Tianjin city, have been ordered to close/scale down operations for around a week or more due to power rationing amid the ongoing shortages. Tianjin city has a soy processing capacity of around 750k tonnes per month. Around 80% of Chinese soybean demand comes from processing plants where soy is converted into oil and meal. Shutting down operations is likely to weigh on soybean demand in the immediate term. Rising energy prices combined with Beijing's efforts to curb pollution and enforce environmental regulations have created power shortages across the country. These shortages have affected various industries including aluminium, steel and now food processing. On the positive side, lower soybean processing is likely to tighten the domestic oil and meal market and support crushing margins, which would help increase operating rates once power supplies return to normal.

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