



Market Weekly

Commodities, Forex, Futures and Options

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HEADLINE OF THE WEEK: "Russia to seize grain export controls" (Financial Times, 8/1/2008)

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WEEKLY RECAP

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"The recreation of Soviet-style state trading will aggravate anxieties of food-importing countries about their dependence..."

The CFTC may be looking in the wrong place for the manipulators of commodity prices. With Russia having successfully nationalized its oil industry, it now plans to form a state grain trading company to control up to half of the country's cereal exports. This has intensified fears that Moscow wants to use food exports as a diplomatic weapon in the same way that Gazprom has manipulated natural gas sales. The decision to control food exports is the latest sign of how soaring commodity prices are reshaping the industry. The recreation of Soviet-style state trading will aggravate anxieties of food-importing countries about their dependence on the international market, which has been severely disrupted this year after exporters, including Russia, imposed prohibitive foreign sales duties or export bans. Western diplomats and agriculture industry officials said Russia intended to transform its Agency for the Regulation of Food Markets into a state trader, controlling between 40 and 50 percent of Russia's cereal exports within the next three years. The company would take over government interests in 28 important storage depots and export terminals, including the country's biggest at Black Sea port of Novorossiysk. Dmitry Medvedev, Russia's president, emphasized at the last G8 summit the need for government involvement in foodstuffs trading, calling for a "grain summit" next year in Moscow to discuss "pricing policies and stabilization measures."



After a "speculative" surge in June, September corn has fallen back to just below prices in May 2008.

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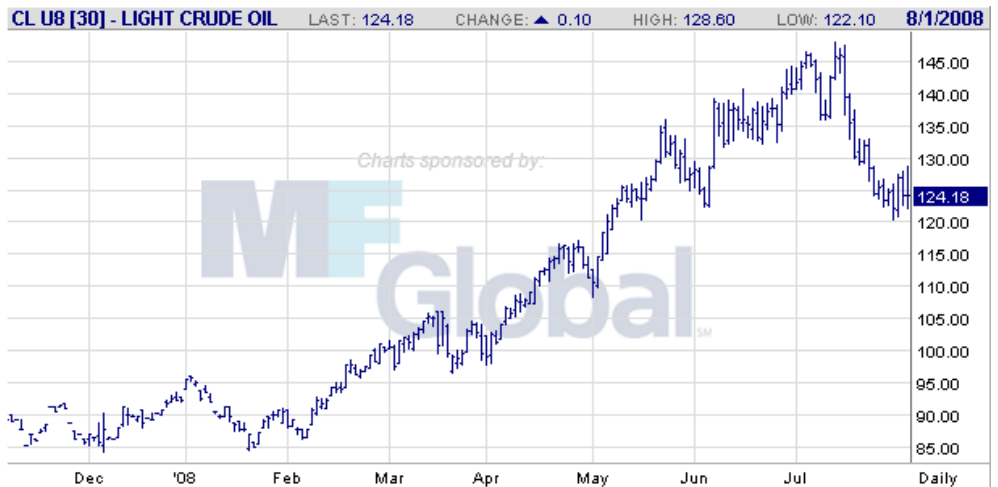
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Headlines from page 1

Commodities prices suffered their largest monthly drop in 28 years in July as crude prices nose-dived more than \$20 from an all-time high of \$147.27 a barrel. The Jefferies-Reuters CRB index, a global commodities benchmark, lost 10 percent, its largest monthly decline since it fell 10.5 percent in March 1980, amid worries about lower economic growth damping demand for raw materials. Natural gas, corn, wheat and freight costs plunged last month between 10 and 30 percent, although from record levels. However, lead, used in car batteries, surged almost 25 percent on tight supplies. The fall in energy and agriculture prices will be welcomed, if persisted, by central banks facing rising inflation. Commodities have provided false price signals this year, with the CRB index falling 6.3 percent in March only to rebound strongly. In spite of last month's fall, analysts are split on whether the commodities prices have set a peak for the year. But the general bullish outlook is, nevertheless, cracking, with Deutsche Bank's strategists warning that oil prices would fall below \$100 a barrel by the start of next year. The IMF has warned that although the global economy weathered the crisis during the first half of the year, "global growth is expected to decelerate significantly in the second half of 2008." Meanwhile, technicals for the key commodity indices are sending strong bearish signals, which could trigger further sales in August.

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Those inclined to conspiracy theories may believe that lower oil prices have something to do with the election.

"The country responded to soaring prices by ramping up domestic commodity production and foraging for alternatives."

Industrialization in the world's third-largest economy has provided a huge boost to commodity prices in recent years. From 2003-07, the country accounted for almost all the global incremental growth in demand for lead; 70 percent for aluminum and 62 percent for copper. China's economy has grown in excess of 10 percent annually for five years in a row. Yet China can still spoil the day for commodity bulls. The country responded to soaring prices by ramping up domestic commodity production and foraging for alternatives. Stainless steel producers turned to lower grade nickel pig iron, shipped in from southeast Asia and blasted in local furnaces. By the end of last year this substitute accounted for 7-8 percent of global nickel supply. In 2005, China's copper production rose 42 percent versus 7 percent for consumption. The energy-intensive aluminum industry is particularly hard hit: big producers are cutting production by up to 10 percent from this month. Slower economic growth will play a part in denting global demand. But more important is China's unwillingness to pay the very prices it has helped inflate.

ECONOMIC REVIEW

According to the Commerce Department, the nation's economy shrank slightly at the end of 2007 despite tax rebate checks aimed at propping up growth, and expanded at a weaker-than-expected 1.9% annual pace during the last three months. Surging exports as a result of the weaker dollar and consumers flush with tax rebates kept the U.S. economy growing in the second quarter, but the uptick wasn't strong enough to squelch talk of recession. The report showed an economy beset by a heap of woes, ranging from a continuing slump in home construction to a slowdown in business investment. The dollar's weakness helped exports rise 9.2% while imports declined at a pace of 6.6%. At the same time, high oil prices led to a 2.7% drop in petrol use. Meanwhile, the U.S. housing sector continues to be a drag on the economy, but was not as bad as in previous quarters. At the same time, the U.S. economy shrank at the end of last year, and prior reports of economic growth may have been overestimated as higher dollar volume in the economy may have stemmed from higher prices rather than increased output. The last time the economy contracted was in 2001, and investors should recognize that it may weaken further as the temporary boost which resulted from tax rebates, fades.

On the other side of the Atlantic, high energy and food costs in the eurozone pushed annual price rises to 4.1% in July, another record for the nine-year-old single currency region. Eurozone inflation is running at more than double the "close to but just below" 2% level the European Central Bank sees as providing price stability. But consensus among economists is that the ECB will hold rates steady for now amid sign of an economic slowdown and a decline in energy prices. In the past week, eurozone statistics have suggested that economic activity in the region is slowing faster than has been expected. Europe's manufacturing industry contracted for a second month with the Royal Bank of Scotland Group's manufacturing index falling to 47.4 from 49.2 in June. A reading below 50 indicates output declined. Meanwhile, a breakdown of the ECB data showed that first-quarter growth of households' gross disposable income decreased slightly to 3.6%, driven by a decline in net social benefits receivable. Households nonetheless increased spending by 4.3%, which resulted in a drop in the savings rate early this year. Such statistics support a gloomy economic picture reinforced by business and consumer sentiment surveys across the fifteen countries that use the euro.

Next Week's Economic Calendar

Economic reporting from last week caused a surprising amount of both upside and downside volatility...

Date	Time (ET)	Statistic	For Period	Briefing Forecast	Market Expects	Prior
4-Aug	8:30 AM	Personal Income	Jun	0.0%	-0.1%	1.9%
4-Aug	8:30 AM	Personal Spending	Jun	0.4%	0.5%	0.8%
4-Aug	10:00 AM	Factory Orders	Jun	0.5%	0.7%	0.6%
5-Aug	10:00 AM	ISM Services	Jul	51	48	48.2
5-Aug	2:15 PM	FOMC Policy Statement	-	-	-	-
6-Aug	10:35 AM	Crude Inventories	2-Aug	NA	NA	-81K
6-Aug	3:00 PM	Consumer Credit	Jun	\$7.0B	\$6.0B	\$7.8B
7-Aug	8:30 AM	Initial Claims	2-Aug	NA	NA	448K
7-Aug	10:00 AM	Pending Home Sales	Jun	-	-1.3%	-4.7%
8-Aug	8:30 AM	Productivity-Prel	Q2	2.8%	2.6%	NA
8-Aug	10:00 AM	Wholesale Inventories	Jun	0.6%	0.6%	0.8%

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MANAGED FUTURES NEWS

The FIA joined with four other financial services trade association in urging the Senate to oppose S. 3268, the "Stop Excessive Energy Speculation Act of 2008." In a letter sent to members of the Senate on July 25, just ahead of an important vote, the five groups said the bill would restrict investment in energy futures, make hedging more expensive, and force trading operations overseas. The bill, which was introduced by Senate Majority Leader Harry Reid, D-Nev., on July 15 in response to the surge in energy prices, would require the CFTC to tighten position limits on energy futures, impose reporting requirements on foreign futures exchanges, create a new definition of "legitimate" hedging transactions, and eliminate "excessive" speculation in energy markets. During the subsequent vote on July 25, the Senate Democratic leadership was unable to win enough votes to proceed with the bill.

CFTC Commissioner Bart Chilton is calling for an independent study to determine just how much speculative investments are having an impact on futures markets. Chilton said Bush administration officials have continuously downplayed the role of speculators on oil and agricultural futures, and that an independent evaluation is needed to take political spin out of the assessment. "I've got to believe that \$250 billion (in new speculative investment over recent years) is having some ... impact" on futures, Chilton said in a written statement. Chilton, speaking at a CFTC Agricultural Advisory Committee hearing Tuesday, called for an independent "blue ribbon commission" to be convened. Chilton, despite his concern over possible volatility from speculators on futures markets, said any remedy shouldn't push large index funds out of the futures markets.

Big banks and dealers should have a central clearing house for the \$62,000bn credit derivatives market by the end of the year, marking an important milestone in efforts to reduce systemic risks from inefficient trading and counterparty exposures. Dealers also committed themselves to expanding automated trade-matching and electronic processing in other over-the-counter derivatives markets when they delivered a progress report yesterday to the Federal Reserve Bank of New York. The NY Fed is spearheading the regulatory drive to cut trading and settlement risks in OTC derivatives markets. The near-failure of Bear Stearns in March sent shivers around the financial world as its collapse would have had profound knock-on effects on other financial institutions in part due to the counterparty credit exposures from thousands of OTC derivatives contracts. Credit derivatives in particular were a cause for concern.

Even as Washington attempts to crack down on speculation in food, fuel and metals, Wall Street is rolling out new ways to bring in money. In May, Credit Suisse Group and Deutsche Bank AG began offering investments in iron ore, a component of steel. About one billion tons of iron ore is mined a year but isn't traded on a futures exchange. So it has been virtually impossible for speculators to bet on price movements. The investment banks were inundated with interest in iron-ore deals, which function like futures contracts.

According to Treasury Under-Secretary for International Affairs David McCormick, the effects of speculation or currency depreciation on oil prices are 'relatively minor in comparison' to supply and demand fundamentals that have been building up for more than a decade. In remarks before the Peterson Institute for International Economics, McCormick noted well-documented cases 'in the past' of small groups of investors cornering markets by hoarding physical commodities. He said the CFTC has found that, 'currently, there is no evidence of hoarding.'

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