February 1, 2011
Macro Economics·Monthly Report

Global Monthly. Issue of February

Commodity price trends in 2011

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Overview

The negative impact of austerity in Europe started to emerge, causing 4Q10 UK GDP growth to fall back to the negative territories again. It also implies the coming difficulties of Euro zone in 2011. Despite the poor perspectives, the ECB stated that it would tighten its monetary policy this year due to its concern on high inflation. On the contrary, the US fiscal and monetary policies will remain expansionary for an extended period to support its growth. Is ECB's concern on inflation right? The answer heavily depends on the future pattern of commodity prices.

Focus: Commodity price trends in 2011

Following stabilization of economies at global level and large injections of liquidities by the central banks of the developed countries, commodity prices have recently significantly accelerated recovering to pre-crisis level. We distinguish two major types of factors influencing commodities in 2011 – general factors at global level; and specific factors linked to demand and supply conditions related to each market. In terms of general factors, we identify four different determinants:

- World growth: world GDP growth will be more stable in 2011 in comparison with 2010, relatively more supported by the US and less by emerging countries. The global economy is to be less dependent on investment and more contributed by household consumption, implying less pressure on energy commodities, and more pressure on food prices to some extent.
- Global liquidity: non-extension of QE policies will progressively lead to a slowdown of world liquidities in circulation, implying less money pumping into the commodity pool.
- Regulation on speculative positions: the US and the G20 are proactive in limiting speculative positions on commodities, thus price pressures could be more suppressed in comparison with 2008.
- Exchange rates: the correlation between commodity prices and the US dollar has been decreased sharply since early 2009 and is close to zero at the current stage, demonstrating the larger role of fundamentals in deciding commodity prices.

Based on our analyses on general factors and specific factors, we attempt to draw a picture of commodity prices from a macro perspective.

- Energy prices are likely to fluctuate in a reasonable band with a moderate upward trend, with oil prices moving in a range of USD 80-120 per barrel. However, geopolitical risk could cause oil prices very volatile in a short period.
- Food prices will continue to face tight upward pressure due to sever weather condition and sharply rising demand of emerging countries.
- Base metal prices are likely to rise continuously as long as its largest consumer – China – keeps its growth above 9% YoY in 2011 pulled by investment on high speed railway, welfare housing and western region development.
- Precious metal prices including gold in particular will continue to trend upward given remaining high risk aversion in the short-term and strong and persistent demand of emerging countries due to appetite of reserve asset diversification in the long-term.

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	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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