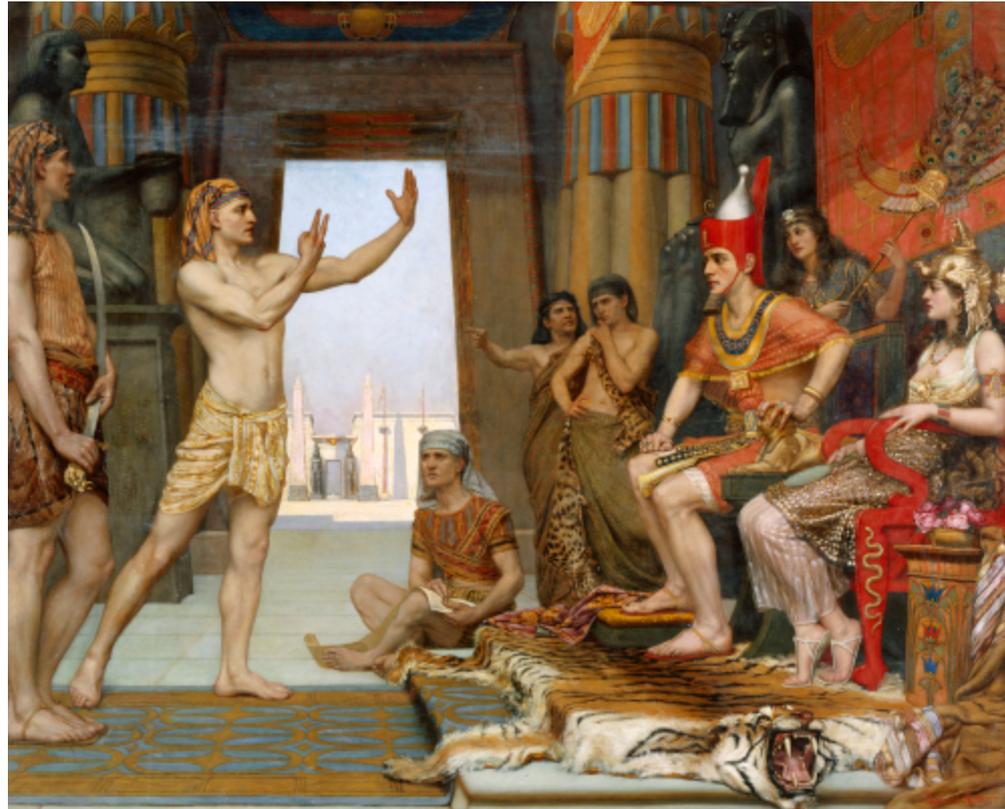


Scarcity amid plenty

Izabella Kaminska

FT Alphaville

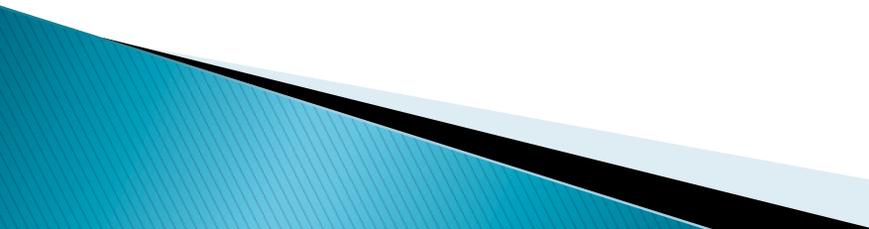
A pharaoh story



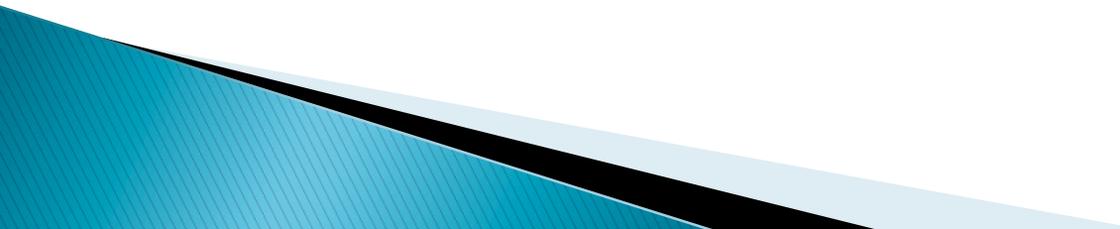
Surplus / Redundant stocks

“Thus the price must fall far enough to curtail production sufficiently to allow the surplus to be absorbed within a period not so long as to eat up, by the costly passage of mere time, too much of the speculative holder’s anticipated gross profit.”

- John Maynard Keynes



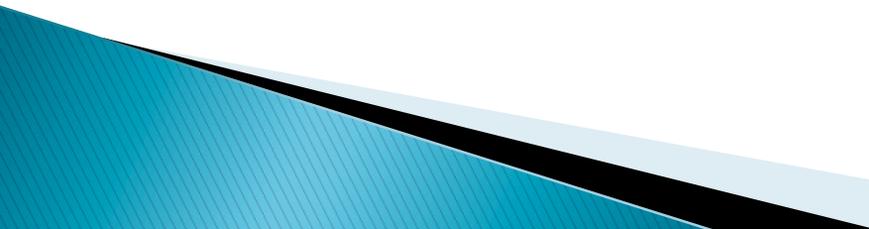
Redundant stock carrying costs

- Allowance for deterioration in quality
 - Warehouse and insurance
 - Interest charges
 - Remuneration for risks in changes of commodity value
- 

Keynes on organisation

- ▶ *“A miscalculation leading to heavy redundant stocks may prove ruinous if matters are allowed to take their course on principles of laissez-faire.”*

John-Maynard Keynes, A Treatise on Money



Commodities markets are cartels

THE GREAT OIL MONOPOLY

*HOW THE STANDARD COMPANY
ROBS THE PUBLIC.*

THE VIEWS OF AN EXPERIENCED OBSERVER
ON THE SITUATION—A BRIEF REVIEW
OF THE OPERATIONS OF MR. ROCKE-
FELLER'S CORPORATION—HOW IT GREW
AND PROSPERED.

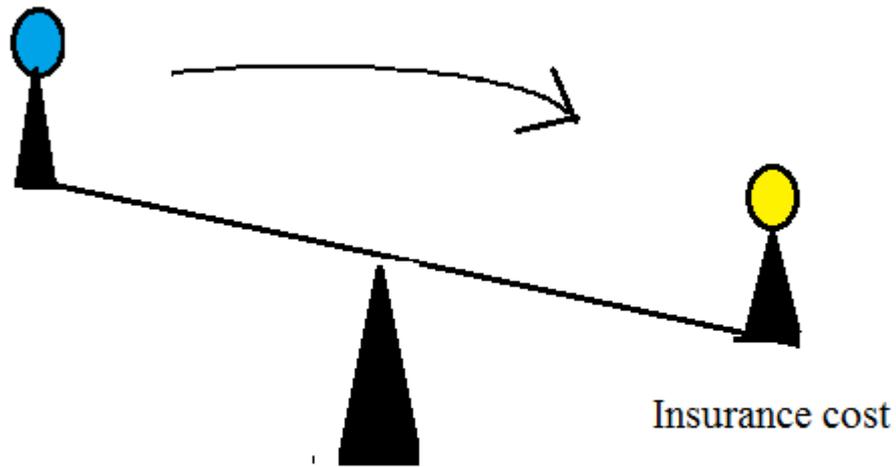
New York Times, Archive, 1882

More cartels

- ▶ The copper restriction in the US
- ▶ The rubber restriction in the straits settlements and ceylon
- ▶ BAWRA organisation of carrying stocks of Australian/SA wool
- ▶ The coffee valorisation of the brazilian governmentt
- ▶ The tin Valorisation of government of federated malay states.

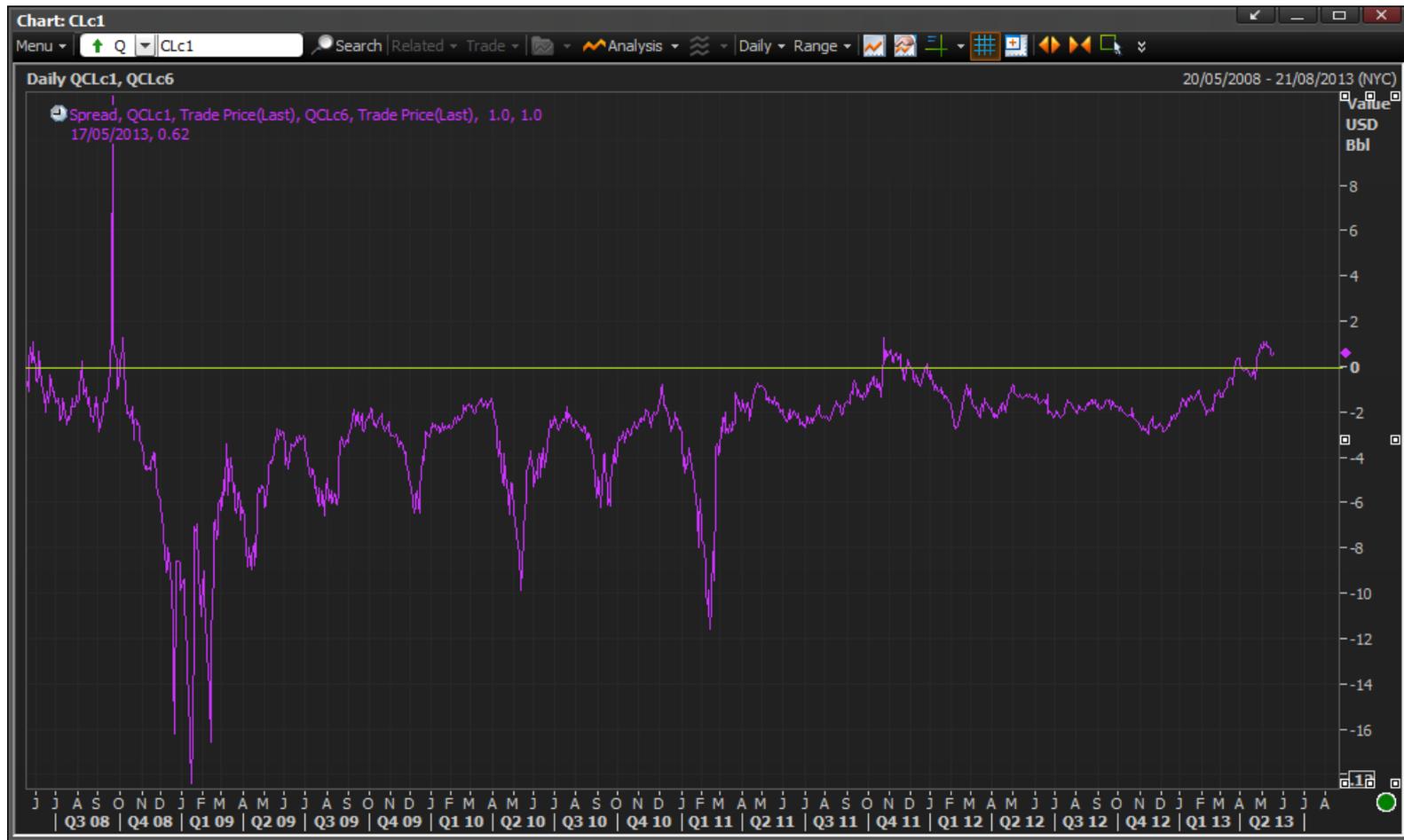
Normal Backwardation

Supply and Demand Balanced

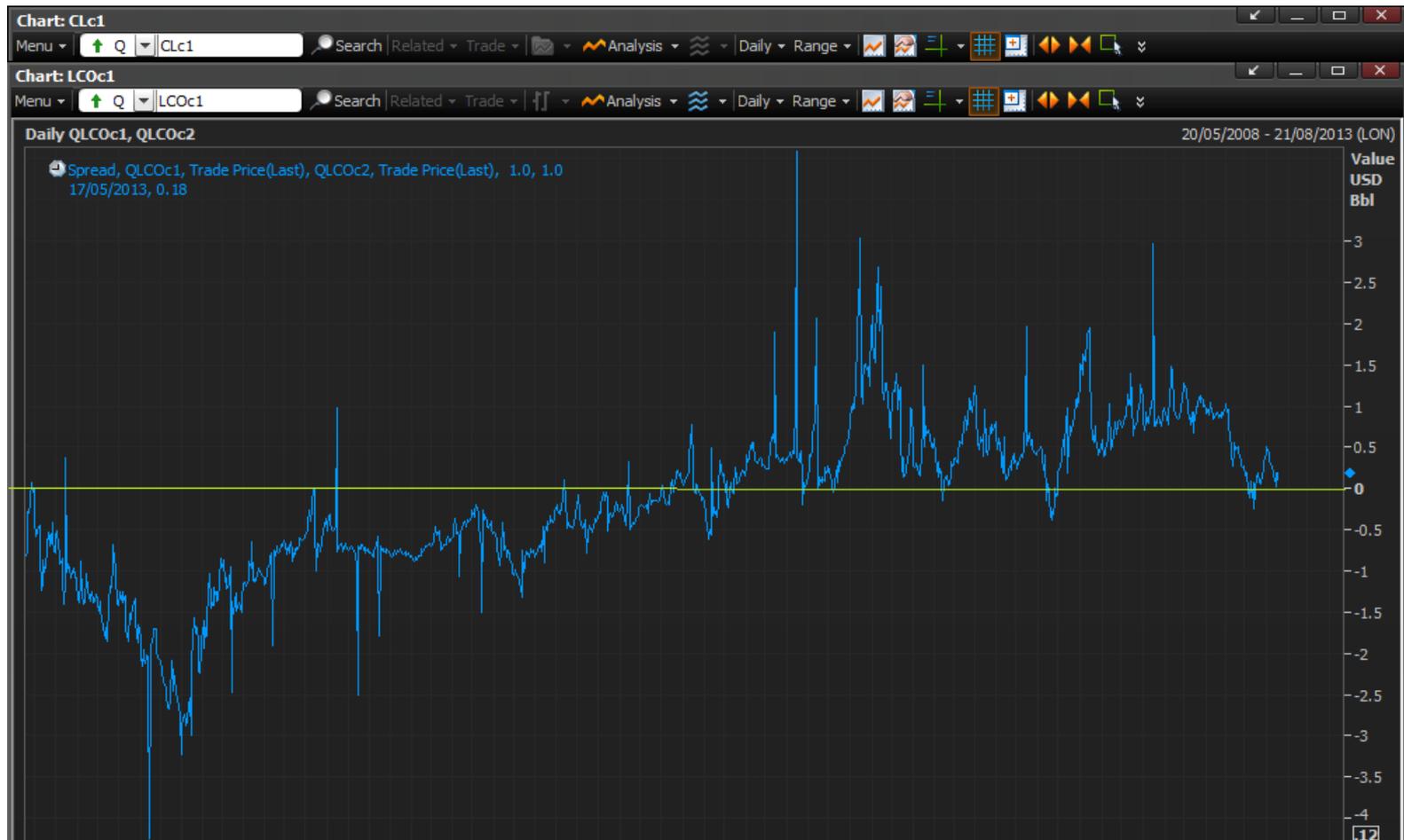


"Normal Backwardation"

Super-contango irrationality

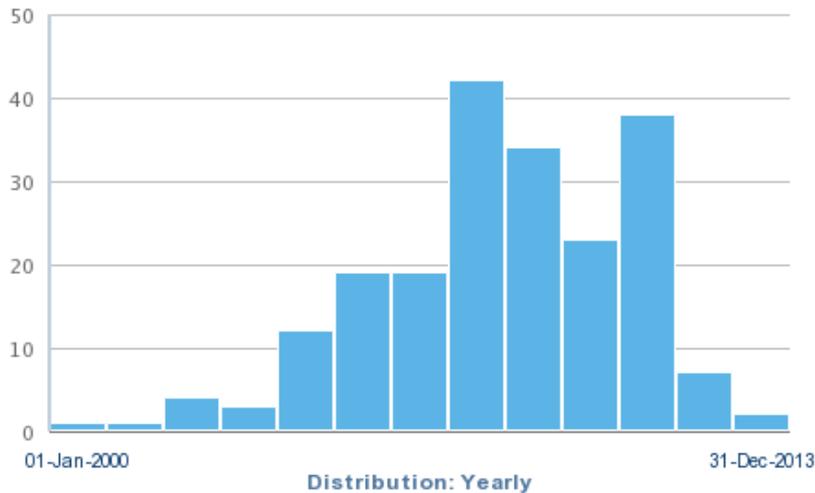


Super-contango irrationality



Was it the marketing?

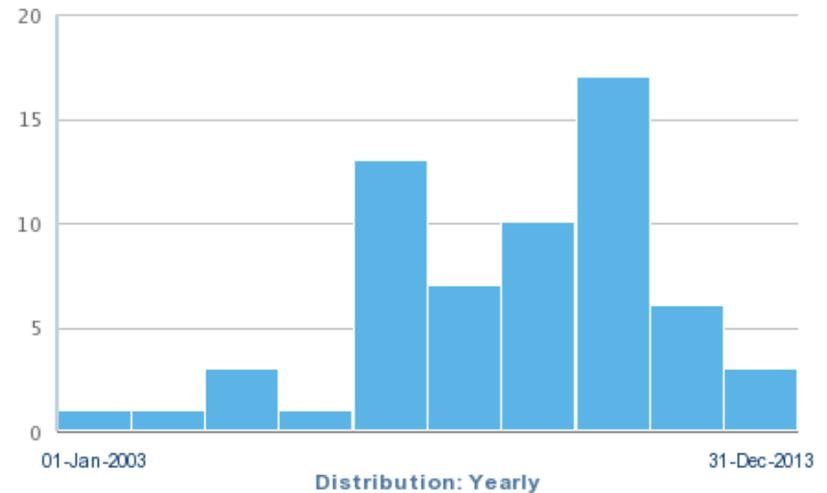
"Bullish commodities" searches



205 documents From 01/01/2000 to 20/05/2013

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"Bearish commodities" searches



62 documents From 01/01/2000 to 20/05/2013

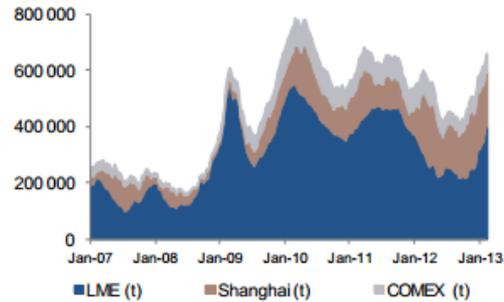
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From Factiva

From Factiva (no incidents pre-2003)

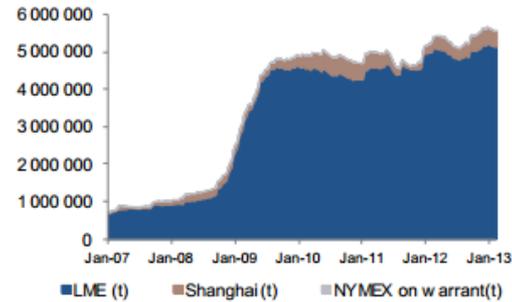
Inventory trends

Copper stocks at exchanges



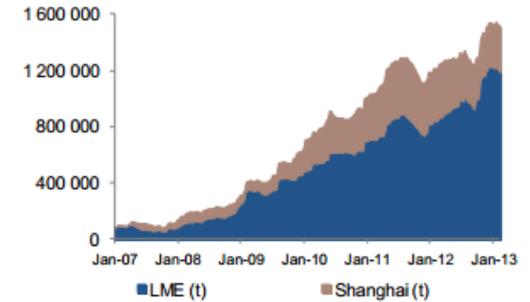
Source: LME, COMEX, Shanghai exchange & SG Cross Asset Research

Aluminium stocks at exchanges



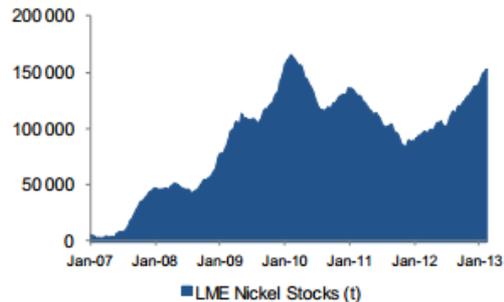
Source: LME & SG Cross Asset Research

Zinc stocks at exchanges



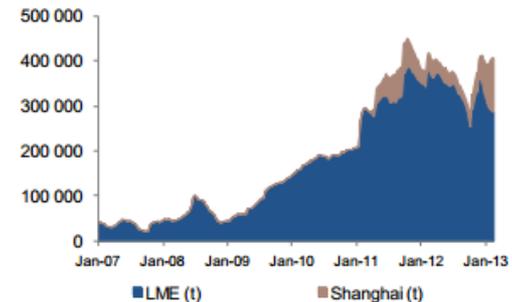
Source: LME & SG Cross Asset Research

LME Nickel Stocks



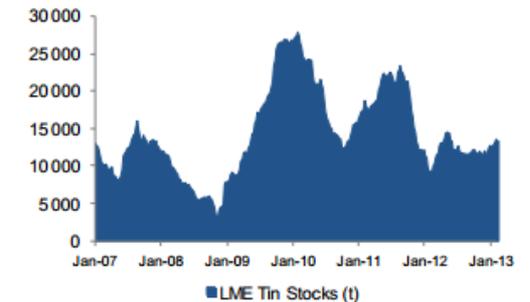
Source: LME & SG Cross Asset Research

Lead stocks at exchanges



Source: LME & SG Cross Asset Research

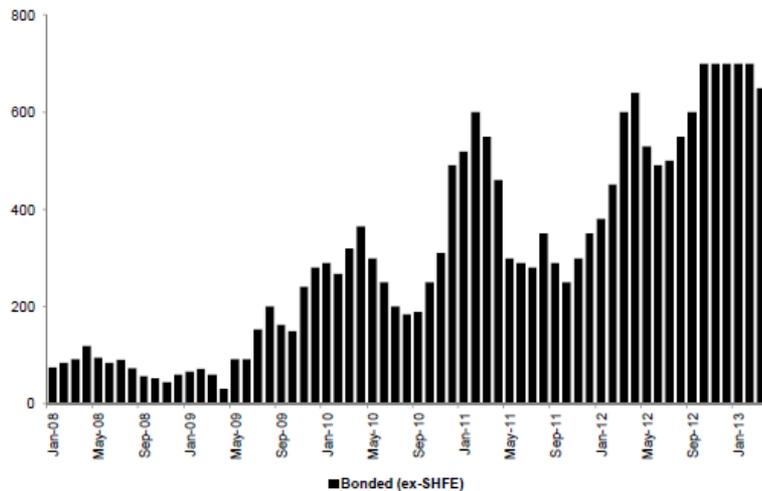
LME Tin Stocks



Source: LME & SG Cross Asset Research

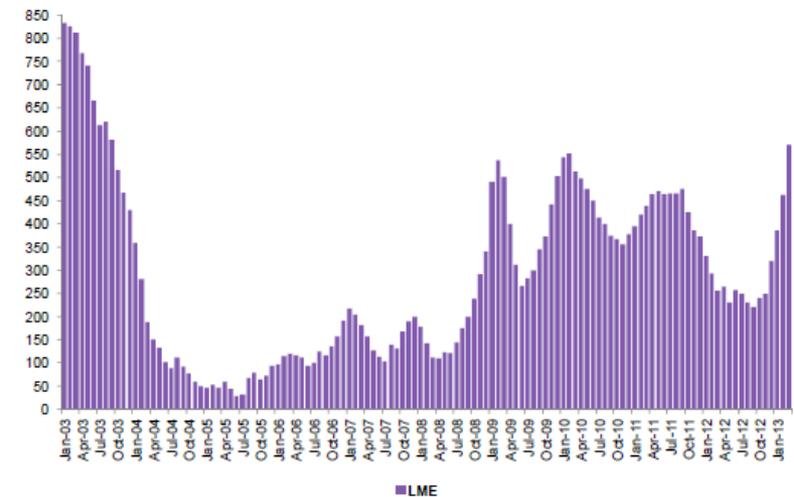
More inventory trends

Exhibit 1: What's 'visible' – a massive increase in Chinese bonded inventories over the past year, and the past 5 '000t



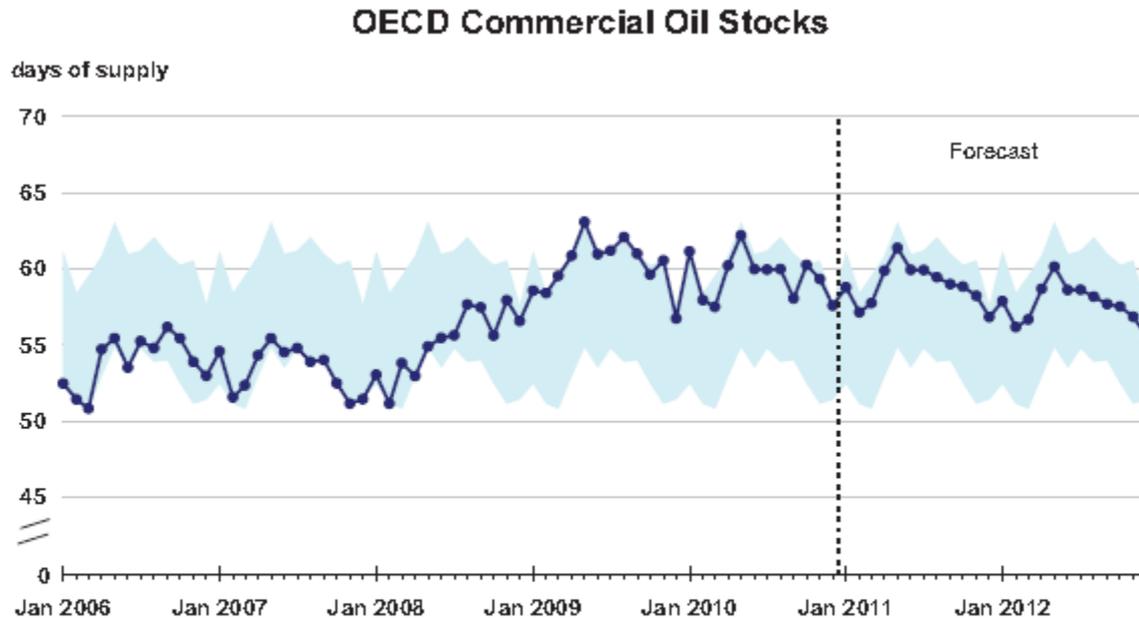
Source: Goldman Sachs Global ECS Research estimates.

Exhibit 2: What's 'visible' – highest LME inventories in more than a decade



Source: LME, Reuters.

Same thing in oil

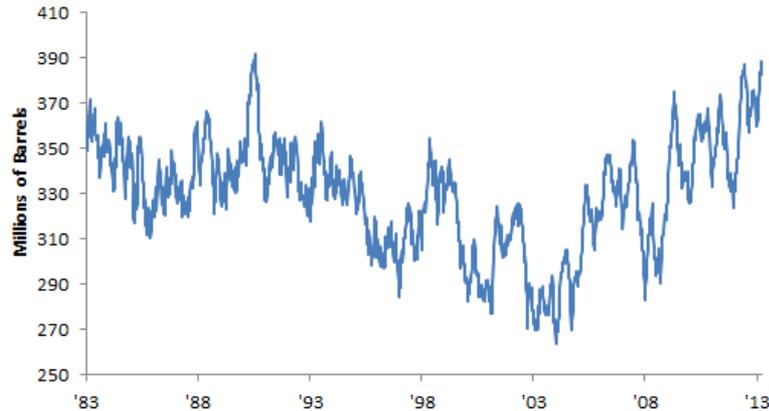


Note: Colored band represents the range between the minimum and maximum observed inventories from Jan. 2006 - Dec. 2010.

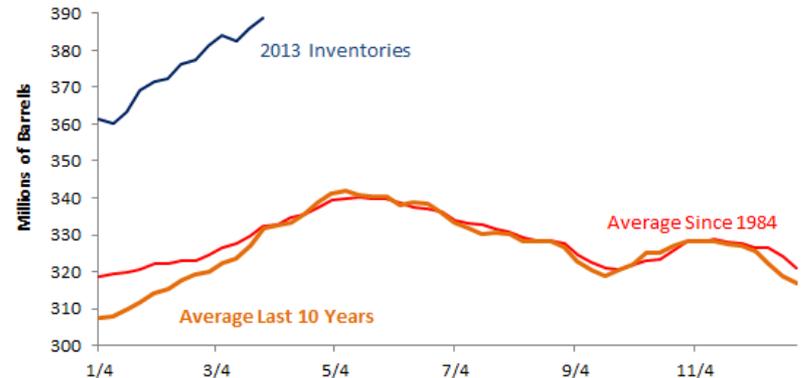
Source: Short-Term Energy Outlook, January 2011

Specifically in the US...

Weekly Crude Oil Inventories: 1983 - 2013



Crude Oil Inventories: Current vs Average (Since 1984)



Courtesy of Bespoke
Investment Group

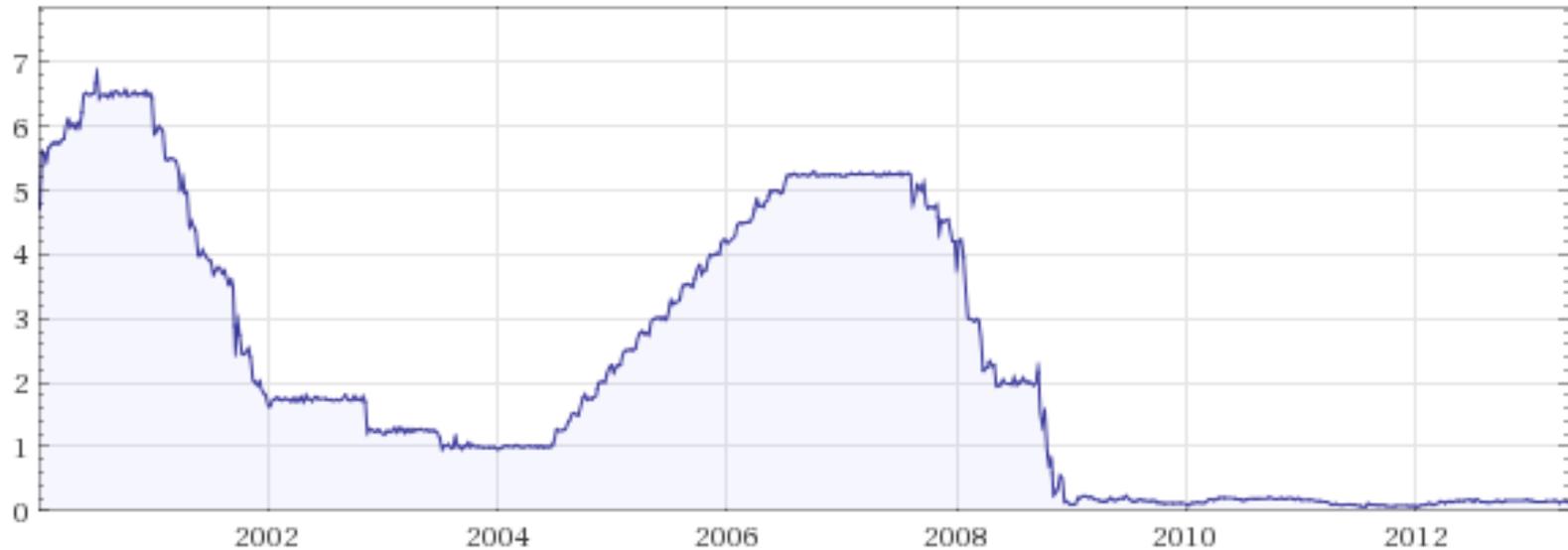
Courtesy of Bespoke
Investment Group

The cost of money connection

Short-term interest rates:

[More](#)

Federal funds rate:



(from Jan 5, 2000 to May 8, 2013) (in percent)

The subpriming of commodities

SHARKS OFF THE BRITISH COAST



Sitting tight: Three of the flotilla of ten tankers that have been anchored in Looe Bay off the Devon coast, cyclically waiting for oil prices to be driven up even further

EXCLUSIVE: These ~~tankers~~ ^{houses} have been parked off our ~~streets~~ ^{streets} for months, refusing to ~~unload their oil~~ ^{sell} until prices have risen even higher. The delay makes millions ~~for speculators...~~ ^{homeowners} and keeps your ~~petrol costs soaring~~ ^{first-time buyers} ~~renting!~~

LADEN with 6 Bay Mass...

Securitisation of commodities

- ▶ *“Where traditional secured loans, backed by a pledge of a warehouse receipt, were once the financing tool of choice, increasingly wholesalers are looking to enter repurchase transactions or to “repo” the copper to banks willing to participate in these structures.”*
- ▶ – Reed Smith (Law news, May 2013)
- ▶ <http://www.idsupra.com/legalnews/issues-arising-in-commodity-inventory-fi-87797/>

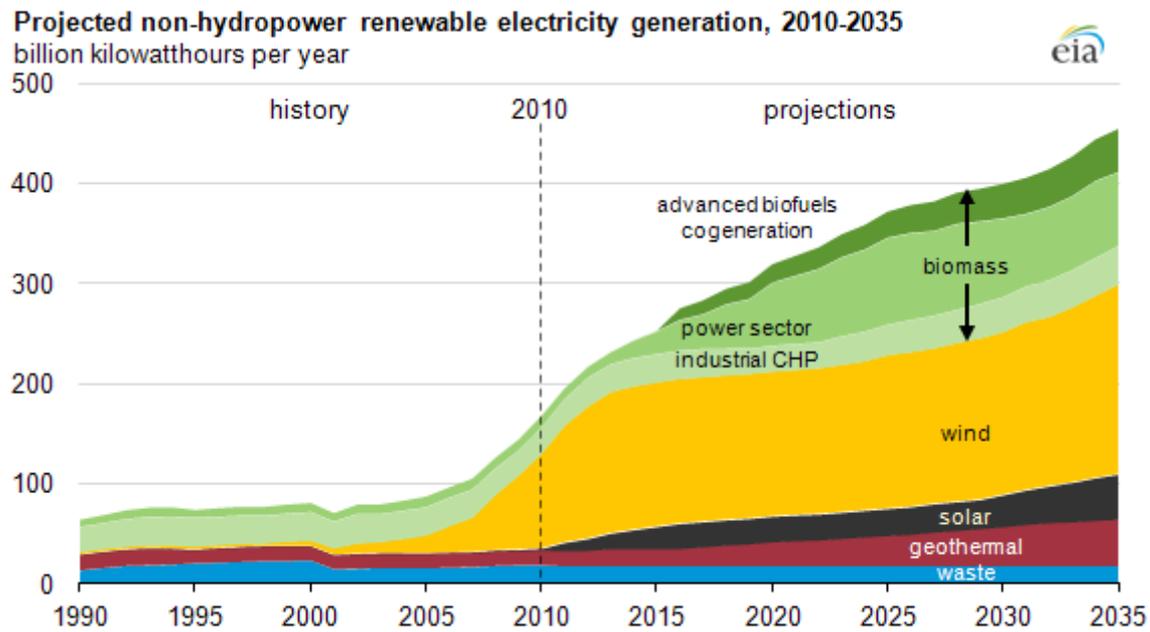
Commodity repos, prepay, long-term contracts

19. BORROWINGS

US \$ million	Notes	2012	2011
Non current borrowings			
144A Notes		948	947
Xstrata secured bank loans		0	2 688
Convertible bonds		2 172	2 152
Euro, Sterling and Swiss Franc bonds		7 530	5 490
Perpetual notes		348	347
Ordinary profit participation certificates		332	750
Committed syndicated revolving credit facilities		5 881	5 907
Viterra senior unsecured notes	24	592	0
Finance lease obligations	28	233	278
Other bank loans		992	1 285
Total non current borrowings		19 028	19 844
Current borrowings			
Committed secured inventory/receivables facilities		3 702	2 640
Uncommitted secured inventory/receivables facilities		1 692	1 295
U.S. commercial paper		726	512
Xstrata secured bank loans		2 696	0
Eurobonds		1 061	0
Viterra acquisition financing facility		1 503	0
Ordinary profit participation certificates		418	533
Finance lease obligations	28	48	39
Other bank loans ¹		4 652	3 205
Total current borrowings		16 498	8 224

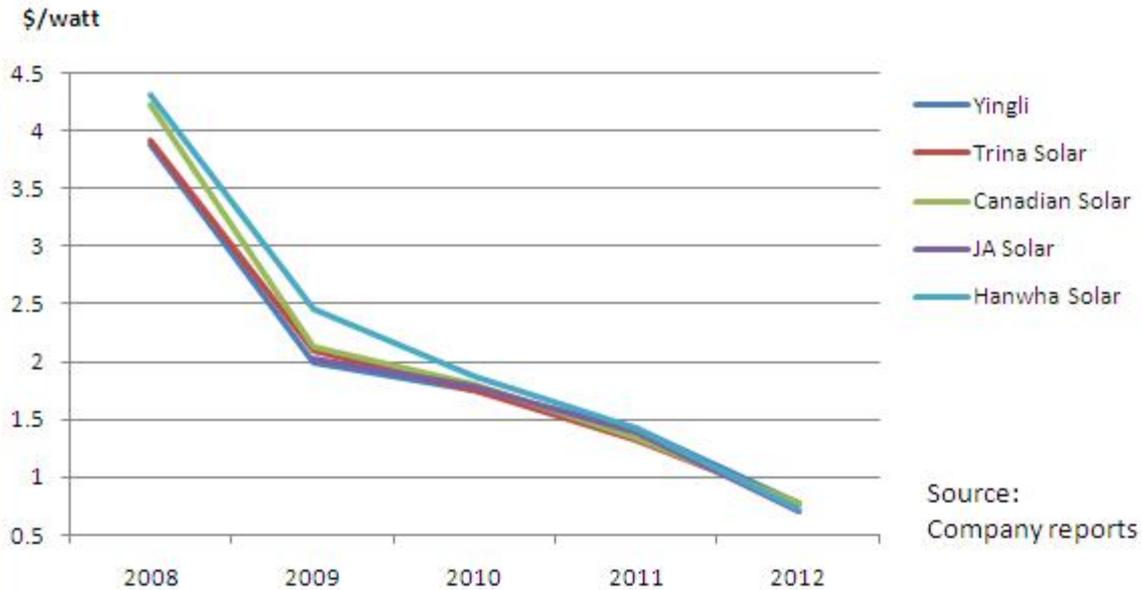
¹ Comprises various uncommitted bilateral bank credit facilities and other financings.

The alternatives?



Solar costs (Reuters)

Average solar module selling prices, top-10 makers



Solar consumption



Tesla



A reminder from JMK

- ▶ *Where there are large stocks, a restriction of new production must be brought about somehow – either by so great a fall of price as to compel restriction, or by an organised voluntary restriction which will bring about the same result with a less fall of price.*
- ▶ *Such a policy only becomes dangerous if the price level aimed at is too high in relation to normal production costs, or if the producers, who join the scheme of restriction, do not account for a sufficient proportion of the total capacity for production.*

What's next?

- ▶ For as long as low or negative interest rates persist there will be no incentive to unwind these secured stocks – at least not until their hedges/maturities expire.
 - ▶ Whether these deals will be rolled depends entirely on speculator expectations.
 - ▶ If speculators stop believing in the bull story and start demanding compensation for unwind risk, prices will correct.
 - ▶ Speculators will have to be replaced with production cuts, which is exactly what's all over the news now.
 - ▶ Arguably, this is also what's started to happen in gold, the most over-warehoused commodity in the world.
- 

Thank you!

