Commodities the Inexorable Boom

The word in the city is that you just can't go wrong with commodities. We are in the midst of a bull cycle for pretty much anything that goes towards making an end product. The cost of sugar has risen 500% in the last six months. Gold is at a record high, oil is making significant gains and is now more expensive than the highs of 2008 for UK buyers. Gas is high demand from Europe and the US and moving these commodities around the world has seen freight prices nearly double since the start of the year.

There is no doubt that the price of many commodities should increase year on year. They are finite and as we use more of them the scarcity of supply starts to hit, and this in turn, sees the value of the commodity rise. However, this one way price increase must be looked at in detail, as history shows us that all commodities prices can have significant ebbs and flows.

Uranium

Recent events in Japan have caused many commodities buyers to become lukewarm with Uranium, but it is very clear that despite the tragic events in Japan, the worlds demand for uranium is growing. Most countries now accept that if the world is to meet carbon targets nuclear generation is the likely route. Although some Uranium comes from old war heads, it is now clear that those able to mine uranium have a substantial advantage, and with Australia and Canada being the main areas for mining there is little political un-rest. Prices have fallen recently to $59/pound, but most long term contracts have uranium priced at $72/pound, if the market picks up in China for nuclear generation, there will be a demand spike, this is exacerbated, as nuclear start up typically requires three times the ongoing requirement for uranium.

Shale Gas

Advancements in drilling technology, have now meant that the production of shale gas and oil is growing substantially. Most of Exxons recent $34bn investment into new sources has gone on shale gas and oil investment. This growth area has happened mainly because oil prices seem set to remain above $50, and so the value in extracting more difficult oil is economically viable. But the other reason is that the growth area in shale gas in more stable political regions, and so reliance on Opec and MENA countries becomes less. The knock on effect we are seeing at the moment is that LNG which was due to go to the US, is no longer required, and there is even talk of shale gas being liquefied from Canada and being exported to Europe. The dash for gas fired generation in the UK is certainly more justifiable with this apparent change in supply dynamics.

Coal

Japan was one of the biggest importers of coal in the world and recent events have seen this importing slow. Coal is now linked with carbon, and there is no doubt that legislation and regulation in Europe continues to effect coal prices more than most. Germany clearly has a big fear with nuclear plant, and they continue to be Europes largest importer, of coal. China's main growth in energy build is coming from coal, and the advancements in technology, have meant that new build coal plants are much cleaner. Furthermore, coal plant offers the most amount of flexibility.

So in conclusion, commodities markets will continue to rise and fall with the natural flow of buyers and sellers, this can create short term spikes and some unpleasant market corrections. Recent oil price falls reflect these corrections, but we must not lose sight of the fact that many fundamental players in most commodities have supply shortages and shipping issues and these whilst often disregarded as inflationary are in fact real price rises that must be reflected in the bottom line of businesses. Powerisk's view is that the power and gas markets are in a state of flux with commodities rising, no clear direction on regulation, and perhaps a possible squeeze on supply on the very areas that governments are trying to promote, so being un-hedged at the back end of the curve may well be quite a risky play.