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London,
May 21-22

Commodity prices forecasts

AIECE General Meeting

London, May 2015

Federico Ferrari

disclaimer

this document is the base for an oral presentation, without which it is incomplete and can give rise to misunderstandings

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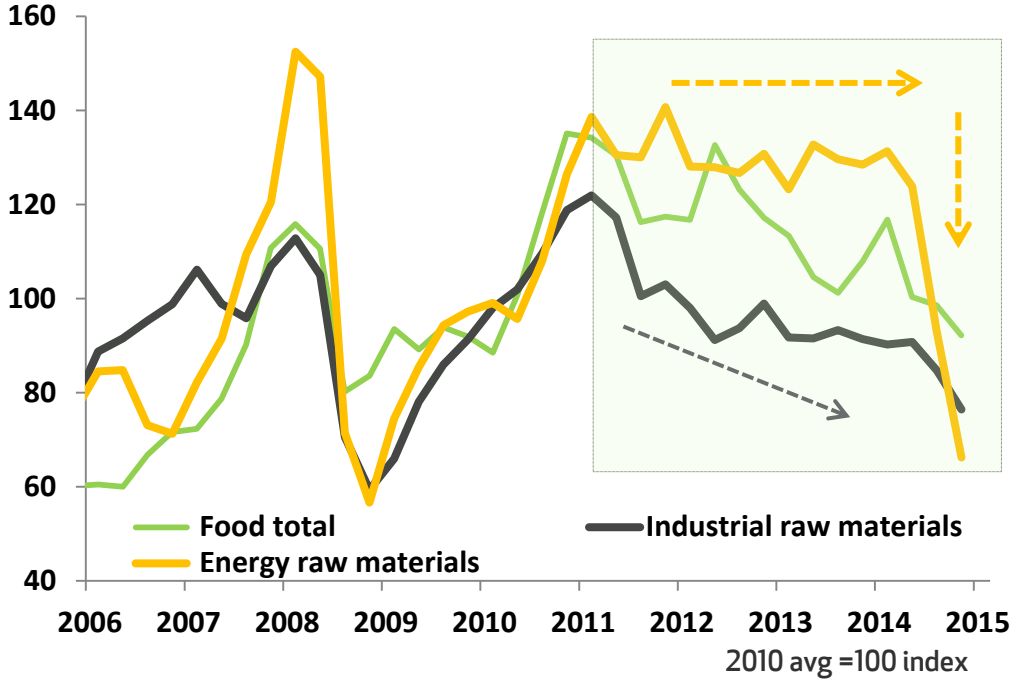
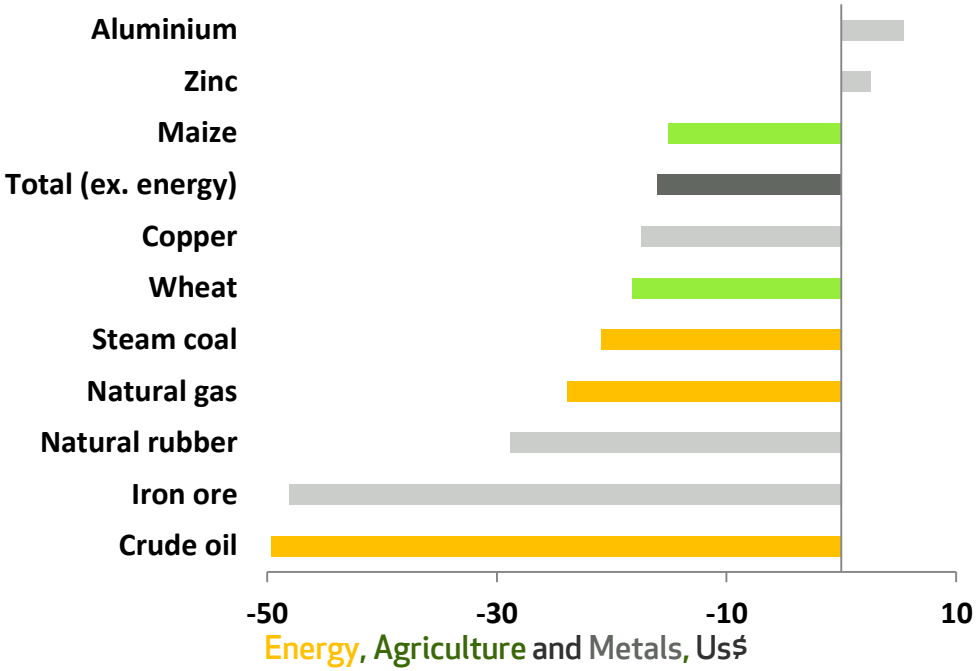
Recent developements in commodity prices

Post-2011 developments of raw materials prices



Avg % chg for selected commodities

2015Q1 vs 2014Q1



The decline of the industrial raw materials prices started in the aftermath of the last massive Chinese stimulus and went until early 2015. In the same period the energy complex (which, in the last years, had always maintained a remerkably stable profile) tumbled, **zeroing the gap that, up to that point, had divided the energy and the industrial raw materials.**

Crude oil is traded almost 50% lower compared to one year ago. In the last 12 months the other industrial commodities retrenched, though far less intensely then energy complex. Oversupply is the key factor behind the recent fall of oil price, while **the declining path of industrial commodities is mostly related to the weakness of Emerging markets growth, particularly in China…**

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Outlook | Chinese slowdown continues…

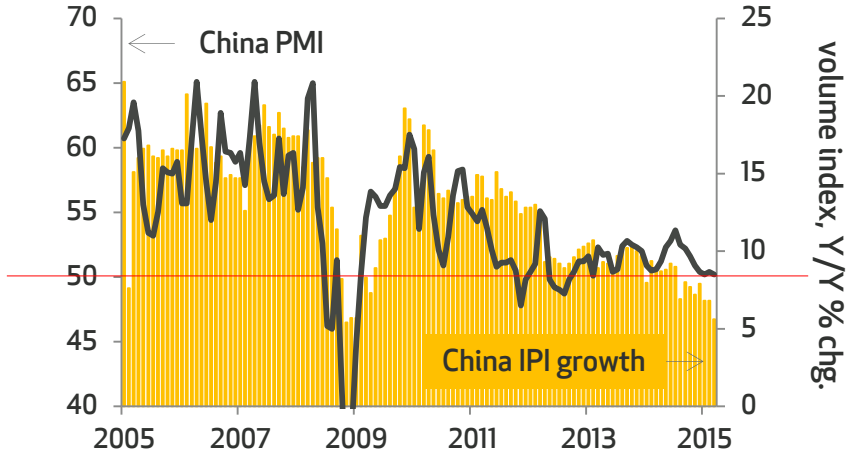
The enormous stimulus program introduced in 2011 saw credit expansion and large-scale investment in infrastructure. It moreover caused the emergence of several problems, **as highlighted by the real estate bubbles and massive manufacturing overcapacity.**

China is now in the midst of a process of rebalancing its exports and public expenditure growth model towards a more long-term sustainable path, marked by a rising share of private consumption at the expense of investments.

This goes hand in hand with a **gradual economic slowdown**, which necessarily implies that import growth will structurally come down in the future. Most importantly, the Chinese leadership is demonstrating a willingness to accept the lower growth rates environment.

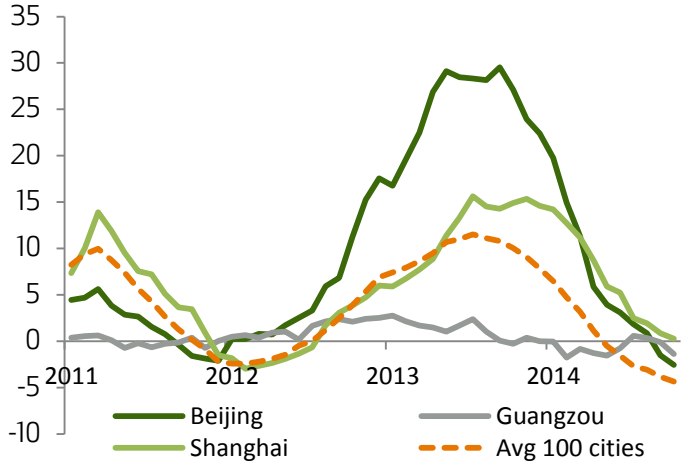
Chinese agenda will shift emphasis from investment and employment to environment, anti-corruption, overcapacity and internal reform. **All in all, Chinese economy is expected to become less commodity intensive compared to the recent past.**

China industrial activity is cooling



datastream

Property prices are falling



property prices (Yuan) in selected cities, y/y % chg

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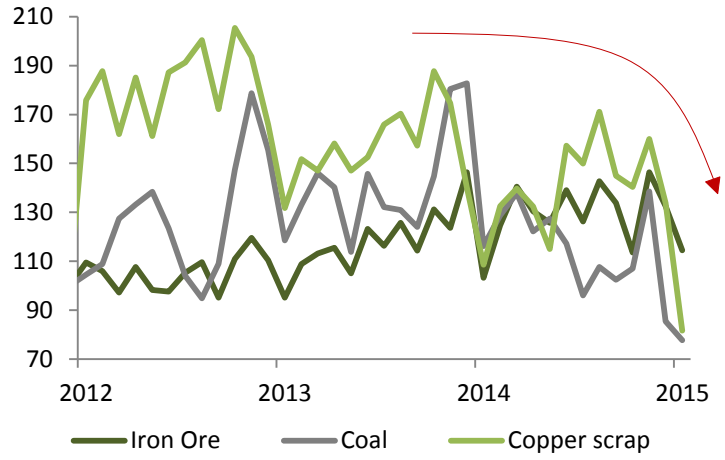
Outlook | … industrial commodities demand is fading…

Not surprisingly in recent years the need for additional raw material steadily decreased; hand in hand with the weakening of the most commodity intensive sectors (industry & building), **the imports volume for most of the industrial commodities slid at a rapid pace.**

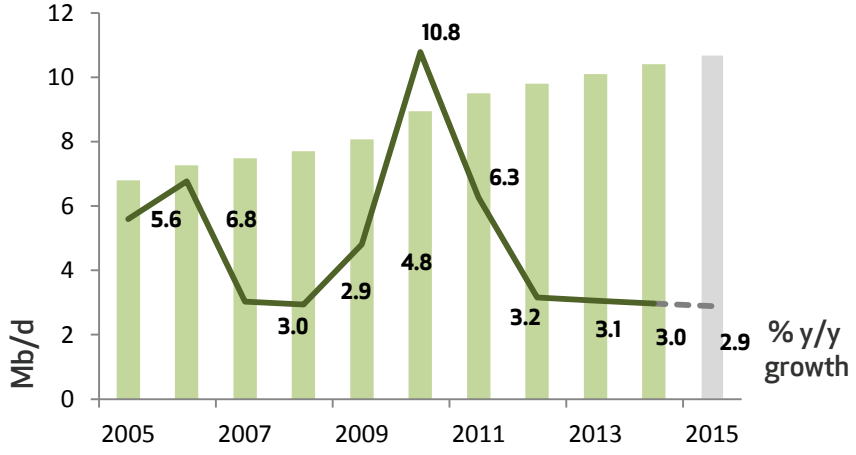
Moreover, after years of driving world energy markets, the growth of China's oil demand is slowing. According to the International Energy Agency (IEA), **the country's oil demand will rise at an average annual pace of 2.6 percent through 2020,** i.e. about half the rate during China's expansion of the previous decade.

China imports of selected commodities



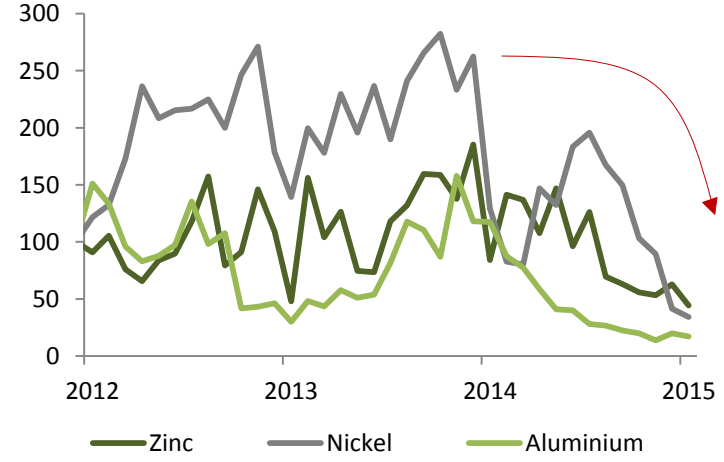
Imports volume, 2010=100, China Customs

China oil demand



International Energy Agency estimates

China imports of selected commodities



Imports volume, 2010=100, China Customs

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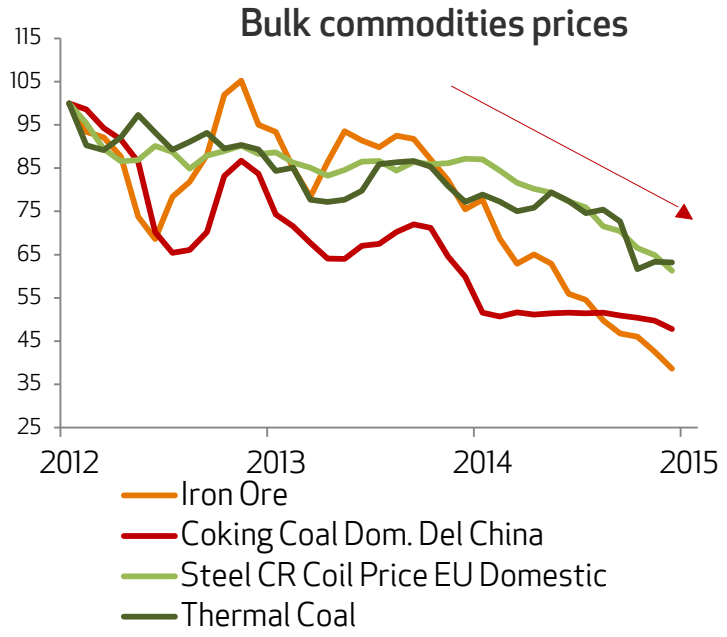
Metals | … no wonder the widespread price declines

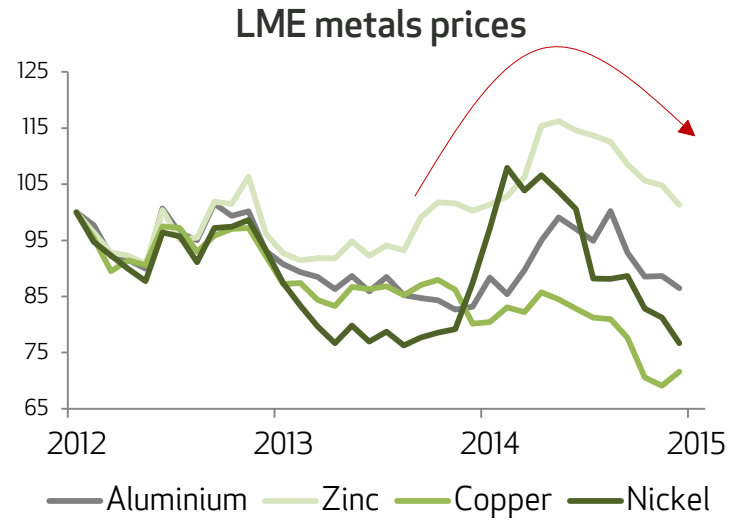
China share in global :	*Consumption*	*Production*
Aluminium	48%	51%
Bauxite		20%
Coking Coal	59%	52%
Copper	47%	35%
Iron Ore	64%	47%
Nickel	50%	35%
Zinc	45%	41%
(Oil)	11%	5%

WBMS statistics and various sources

China plays a dominant role in the global consumption and trade of metals and energy. It accounts for more than 50% of the market for bulk commodities and steelmaking ingredients.

No wonder the steep imports decline for most of the raw materials went hand in hand with price drop in the past few months.





US$, 01/2012 =100 , datastream

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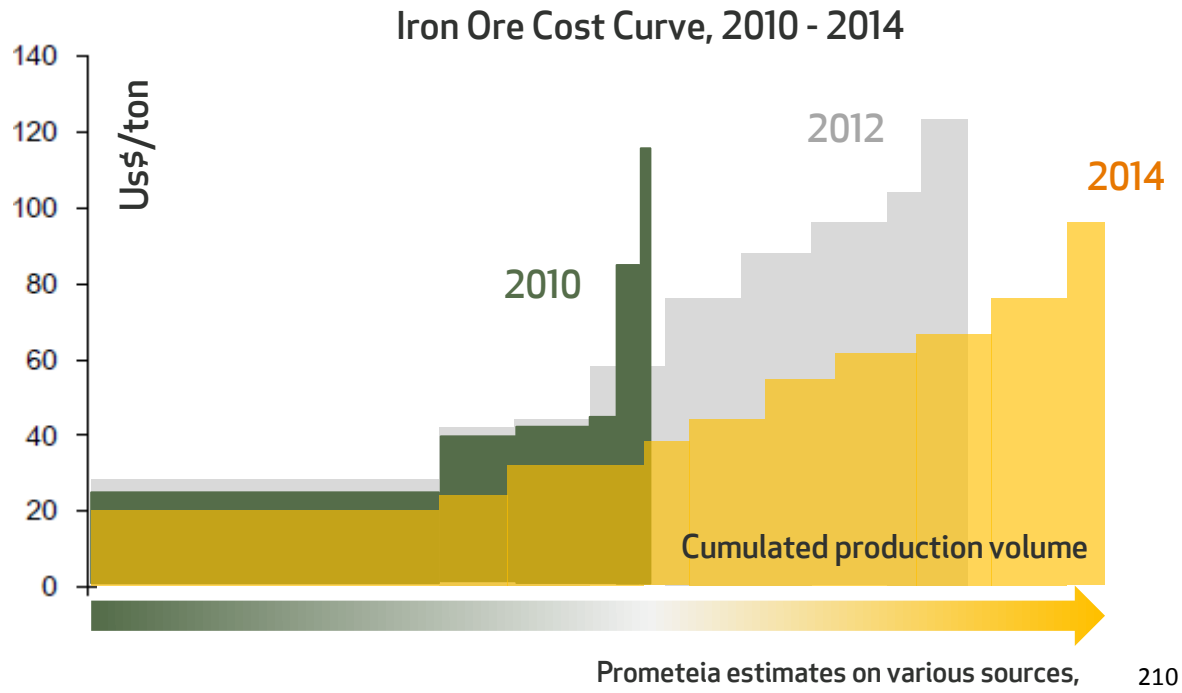
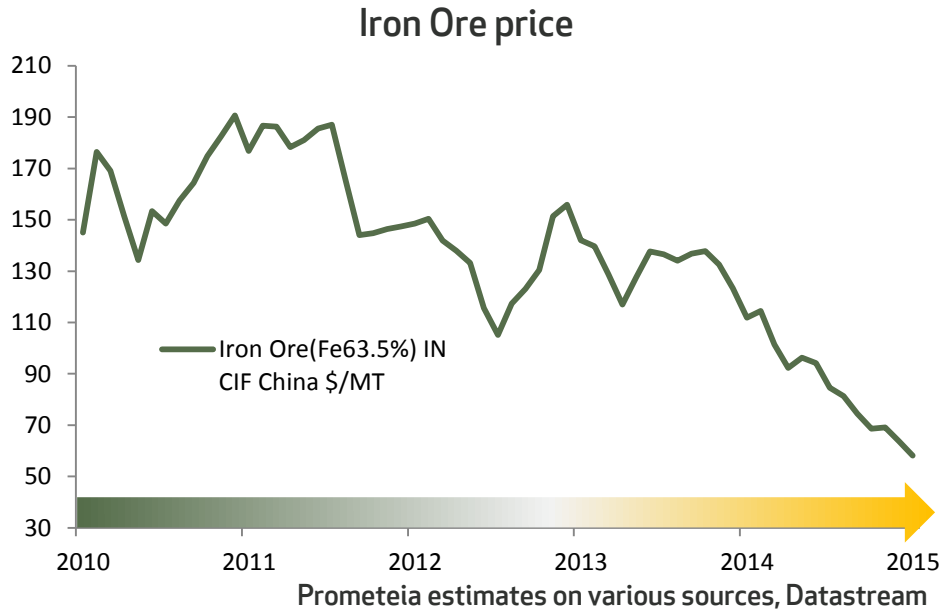
Metals | beyond demand, supply factors are at work



Due to huge investments operated when prices were higher, most metals and bulk commodities benefited from huge capacity improvements in the past 2-3 years…

… what matter most, **the capacity additions have been low cost, i.e. occurred in the low end of the curve**. As a consequence, the entire cost curve shifted to the right, the equilibrium between demand and supply moved to the downside, pushing the high cost operators out of the market.

This is particularly evident for iron ore.



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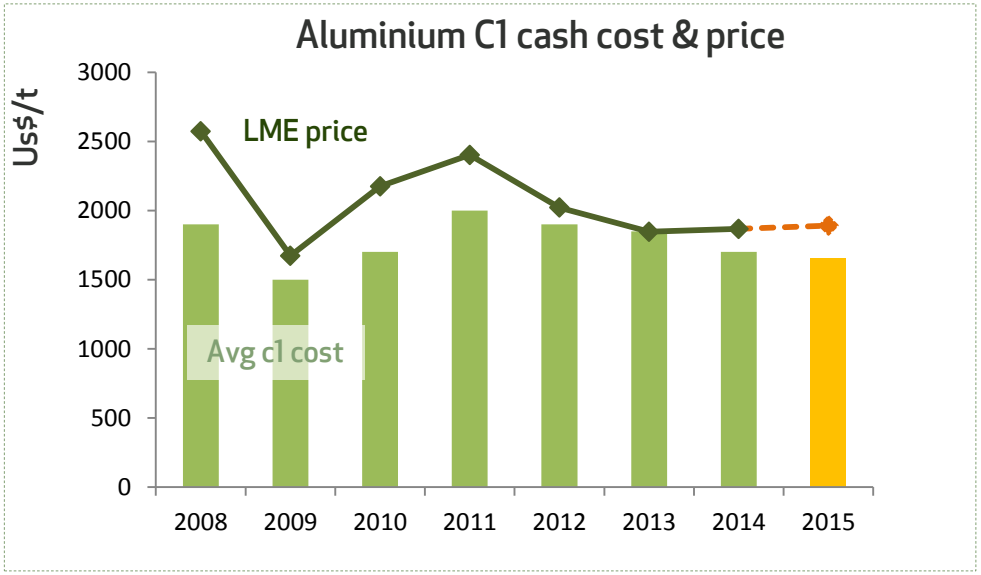
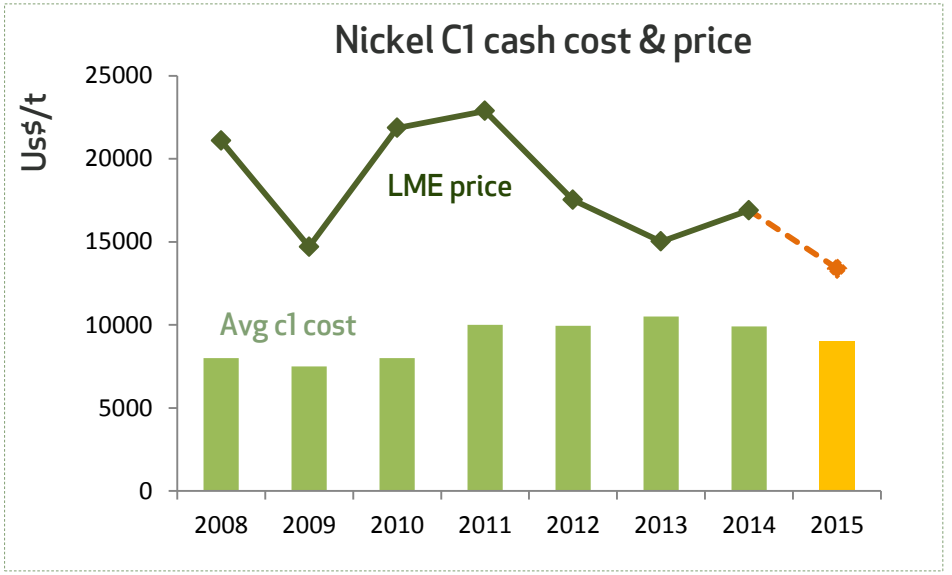
Metals | metals costs on decline (but close to marg. prod. cost)

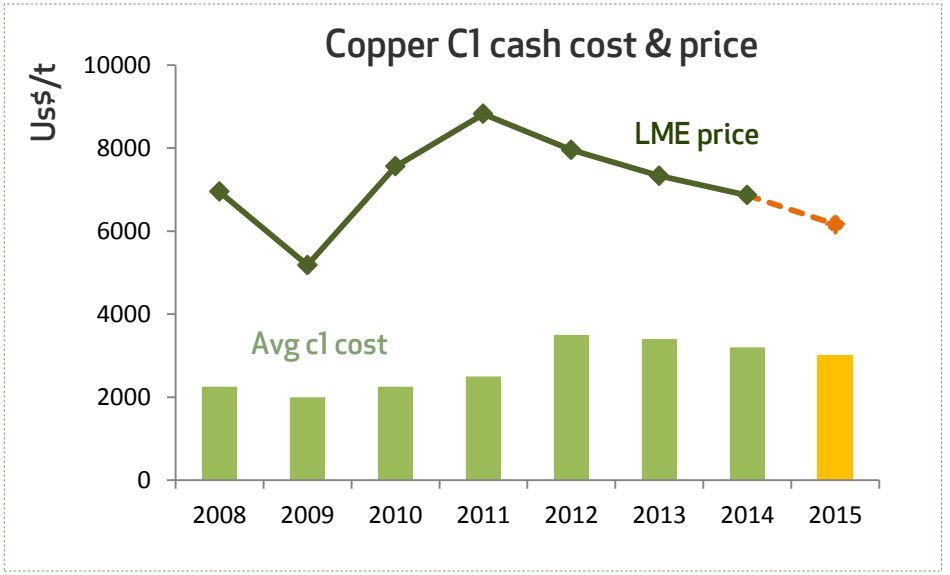




Adding to the fall in Chinese demand and rise in capex spending, following the commodity super cycle **the mining industry efficiency improved considerably.**

Depreciating currencies and falling oil price gave further strength to the cost reversal trend.

Cash cost for base metals are expected to decline between 7 and 15% in 2015, compared to 2013.



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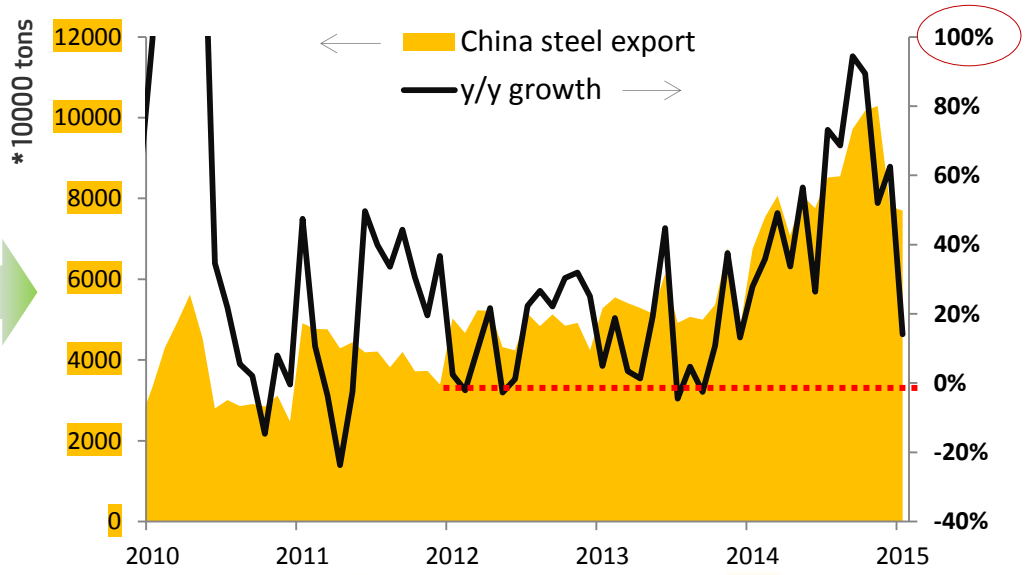
***C1 cash costs** = the costs of mining, milling and concentrating, onsite administration and general expenses, property and production.*

Prometeia estimates on various sources,

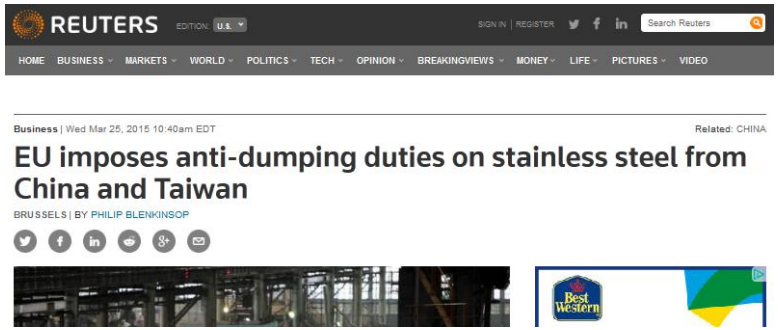
Metals | (the case for steel) the China «peak steel» scenario

Falling domestic demand lead to lower production…

… chinese export increase…



…& triggering policy reactions from importers



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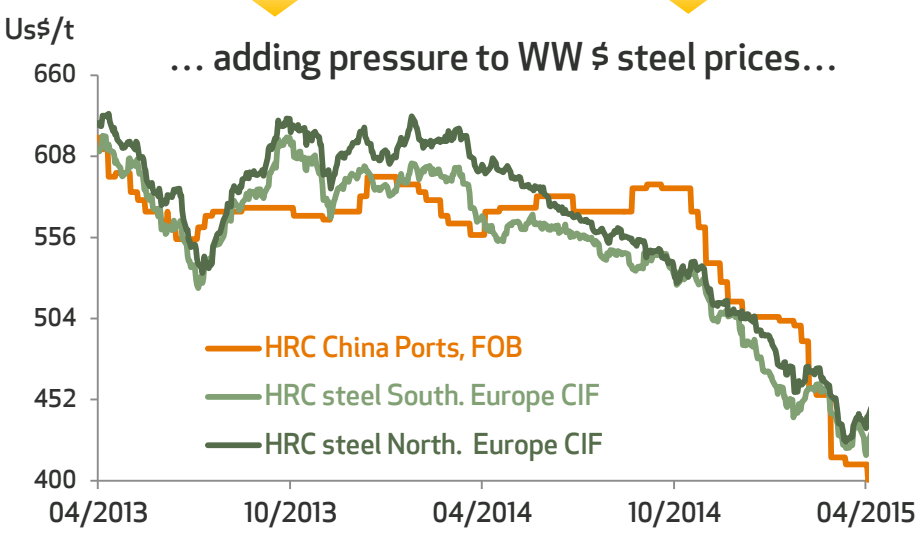
… adding pressure to WW $ steel prices…



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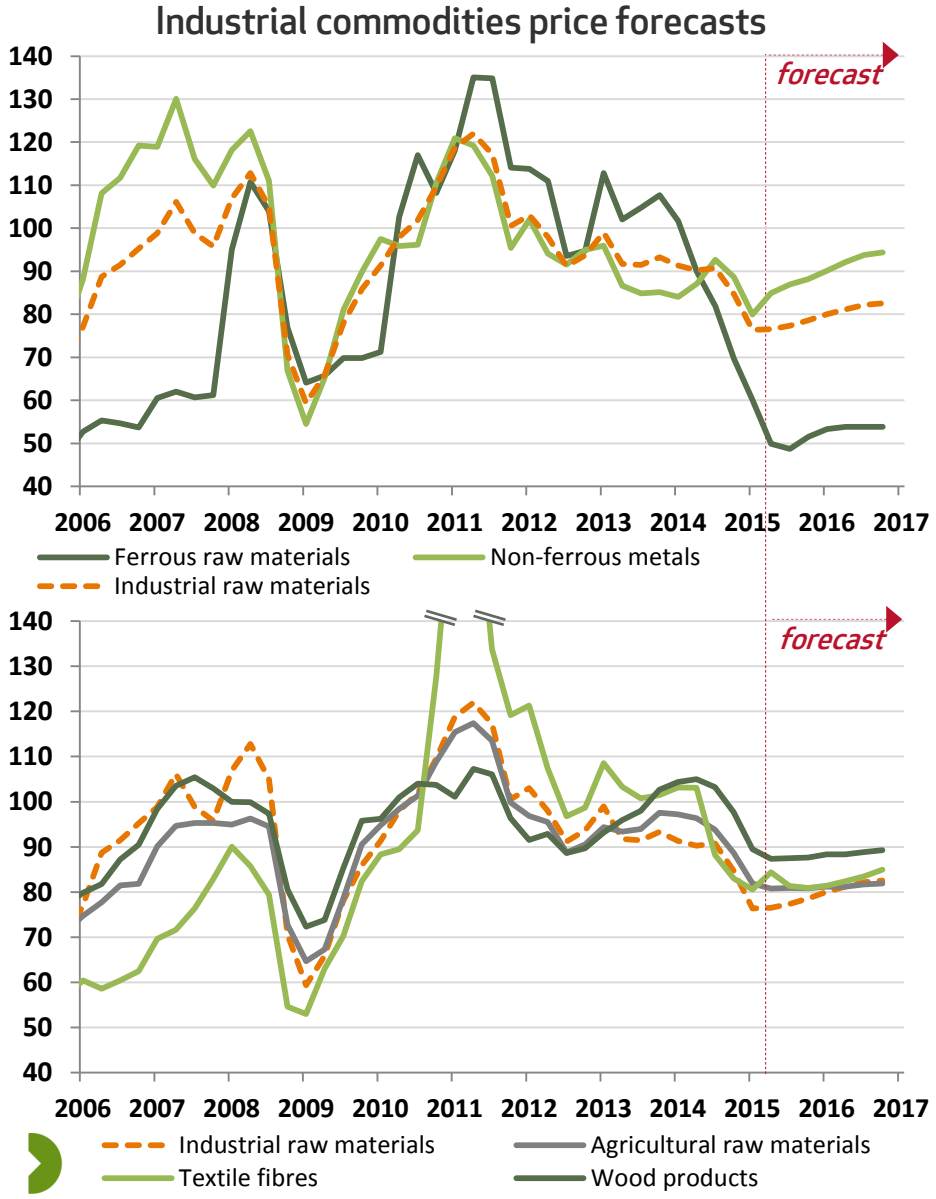
Forecast | Metals & Raw Materials



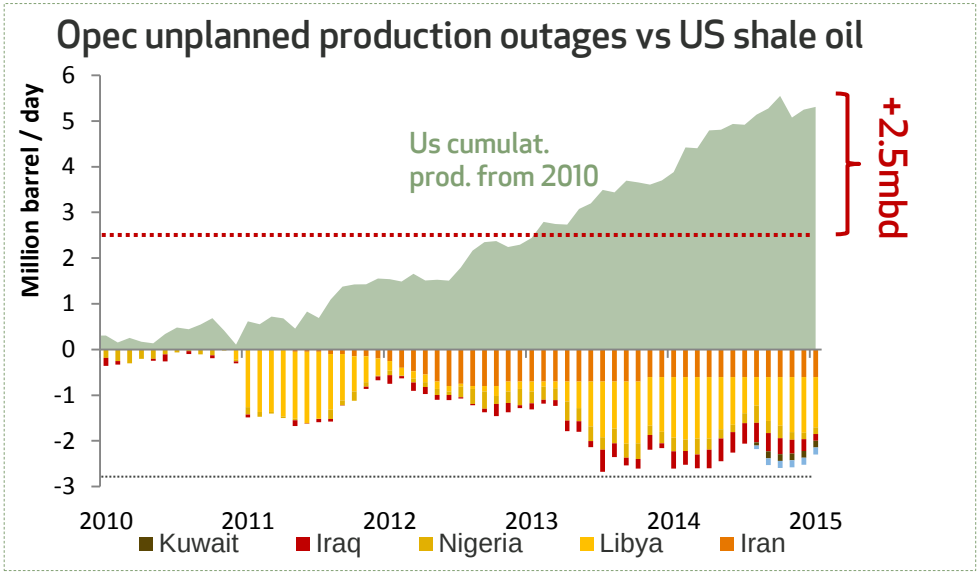
The nonferrous metals aggregate index decreased by 10% in the first three months of the year, even though a recovery started to emerge in most recent weeks. **The price for most of the base metals is close to the marginal production costs**: further retrenchment from current values are then unlikely.

Looking ahead we expect an overall recovery, as mine depletion and closures of uneconomical plants would tighten the physical balance for most of the LME metals. On aggregate, the nonferrous metals are expected to decline (by 3%) in 2015 before showing a substantial recovery starting from 2016.

World steel markets suffer from significant excess capacity, which depresses the steel market outlook. While the old and inefficient capacities are shut markedly - especially by a dominant producer China - more new capacities is coming on stream due to past strong investments.

Wood products should fare relatively better compared to other commodities, due to strong demand and constrained supply, while the textile fibers are expected to slowly recover starting in 2016.

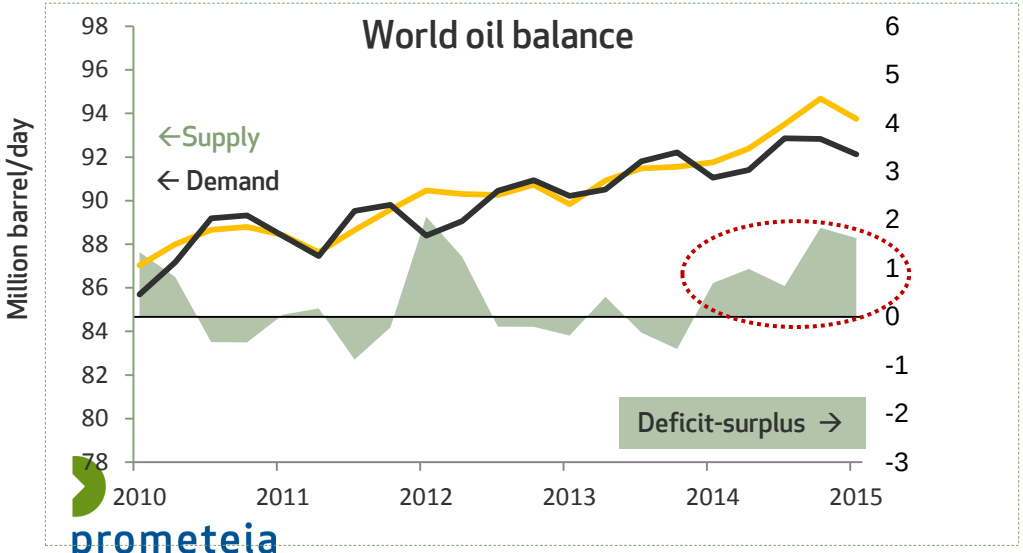
Oil | the global *shale-oil-driven* oversupply

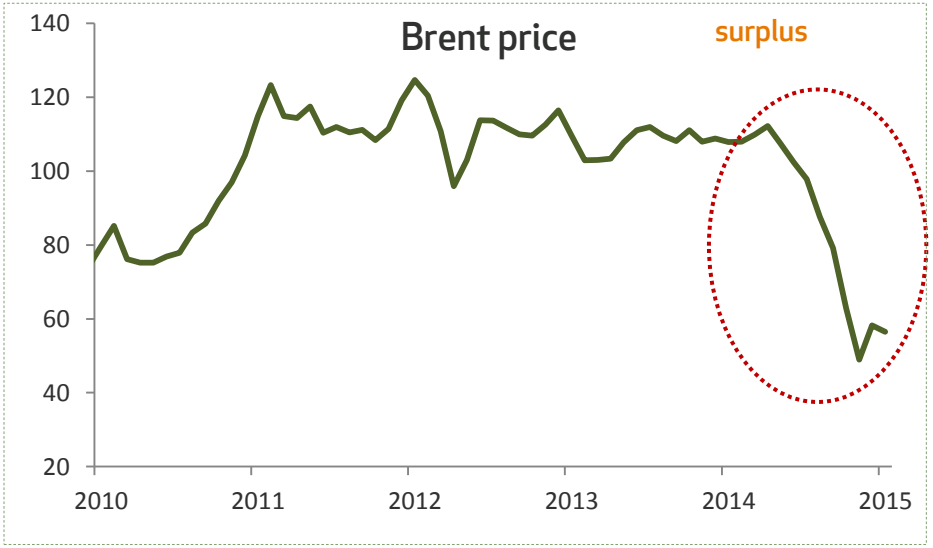


The impact of the shale revolution on global oil prices has been delayed by the emergence of the Arab Springs. However, in late 2013 the Us oil production was already strong enough to offset the entire ME outages and a large part of the global oil demand increase.

The combination of the (temporary) recovery of Libyan production, disappointing consumption numbers**, and Saudi unwillingness to cut its output volumes** pushed the global oil market into a supply glut - **paving the way for a steep price decline.** (2014H2).

International Energy Agency, Energy Information Admin., Datastream





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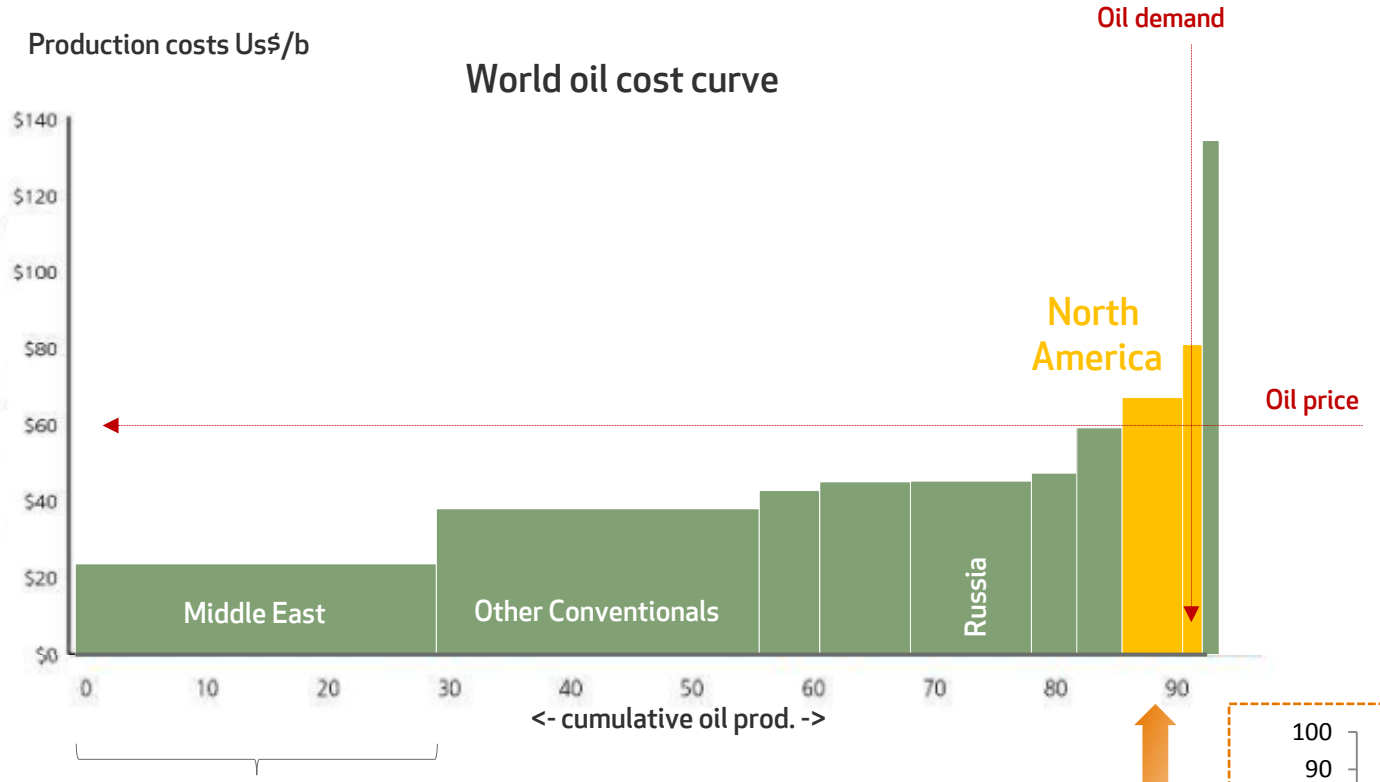
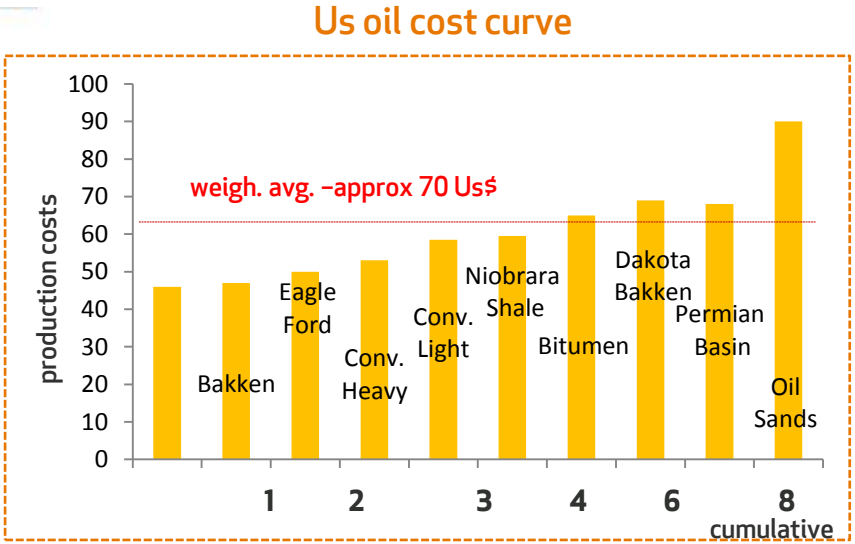
Oil | beyond demand … the oil supply scenario is different !



Shale oil operates
in the upper end
of the global cost curve

While the iron ore supply curve moved rightward and downward due to the new and more efficient capacity additions, **in the case of oil the new capacity additions occurred in the high-end of the curve.**

That means that the Arab producer can manage their output and push the price higher (to maximise rents) or lower (pushing the marginal players out of the market).



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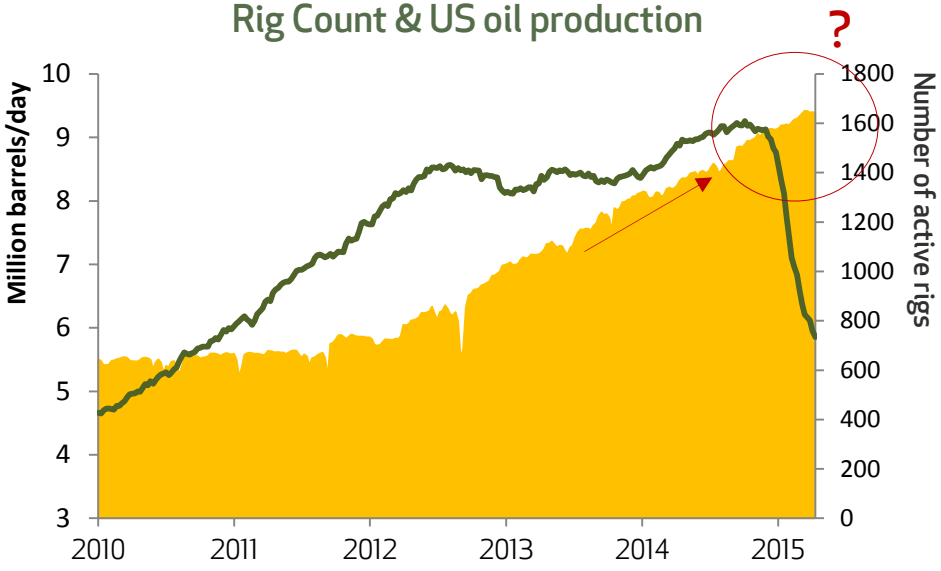
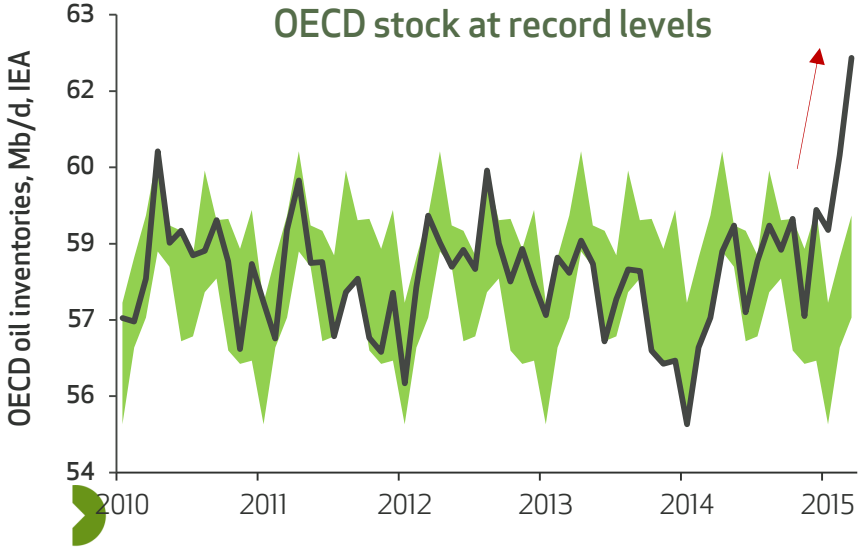
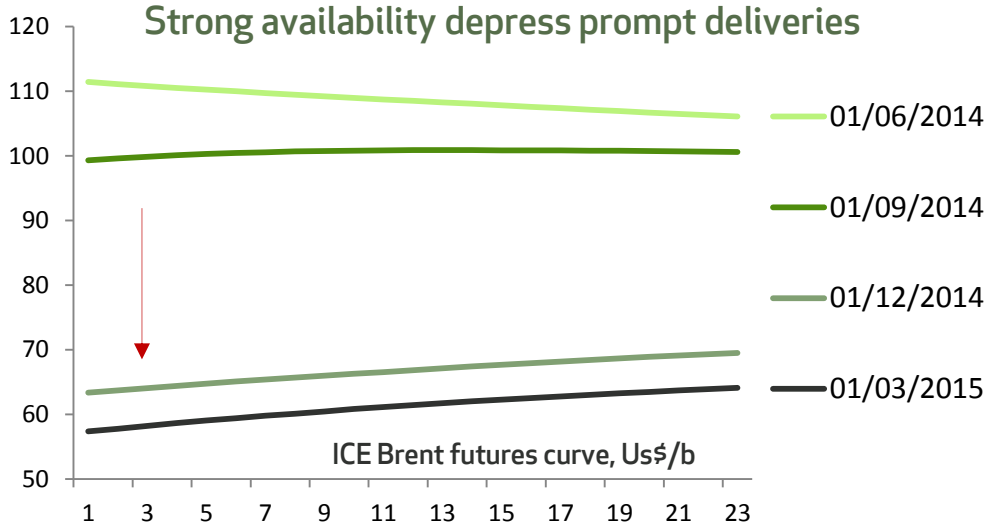
Oil | despite capex fall, no clear signs of production slowdown





The Saudi strategy is apparently working. Shale investments are falling at a rapid pace, especially in the less productive areas of North America, and the total number of NAM active rigs more than halved in a few months.

Interestingly, **the oil price fall has not yet translated in an oil production decline**. Crude oil inventories are indeed accumulating at a rapid pace.



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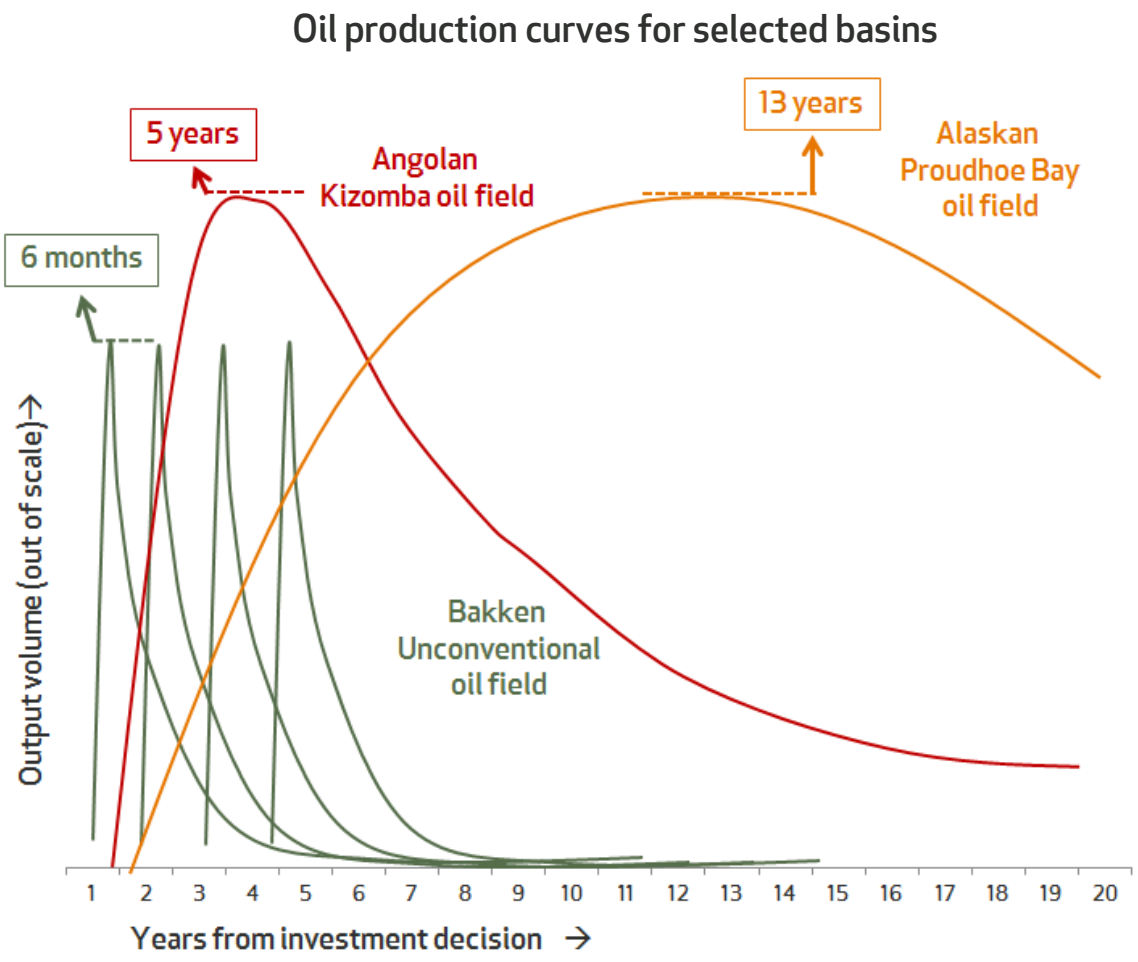
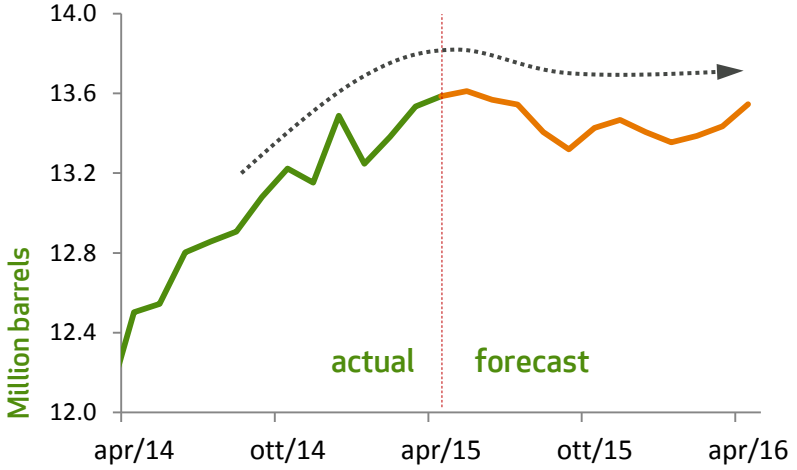
Oil | it's only matter of time before US unconv. supply react



Once the investment is done, a conventional oil field reach its production peak within several years: an **oil conventional well is expected to keep on pumping oil whatever happens to prices.**

In the new unconventional oil field the production peak is reached within a few months. New unconventional oil field requires a continuous flows of investments just to keep the current output volumes unchanged. **If the oil spot price is lower than the breakeven price, the flow will stop – and production halted within months**

Us EIA forecast on Us crude production



Various sources, EIA

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Oil | geopolitical risk looming

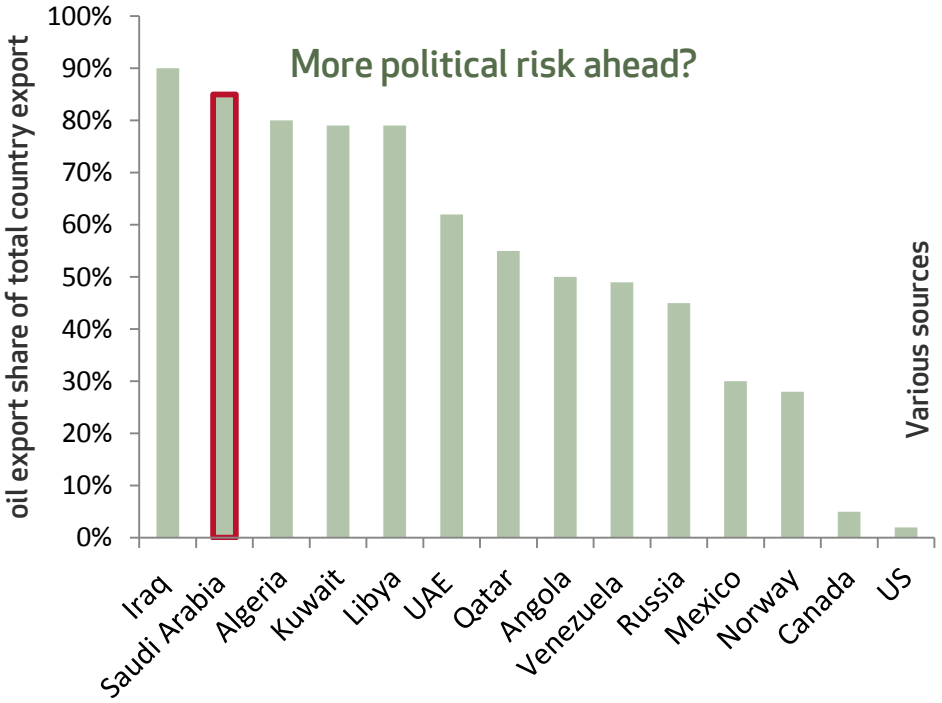
With oil below fiscal breakeven levels, pressure on budgets is increasing amid rising regional instability. **Sovereign reserves can provide cushions, but for how long?**

1 million barrels / day of Iranian supply still offline due to embargo. **What if a comprehensive deal on nuclear with Western Countries is reached?**

Breakeven price* for selected countries, 2014

*oil price needed to balance the fiscal budget, IMF, 2014

Oil export dependence



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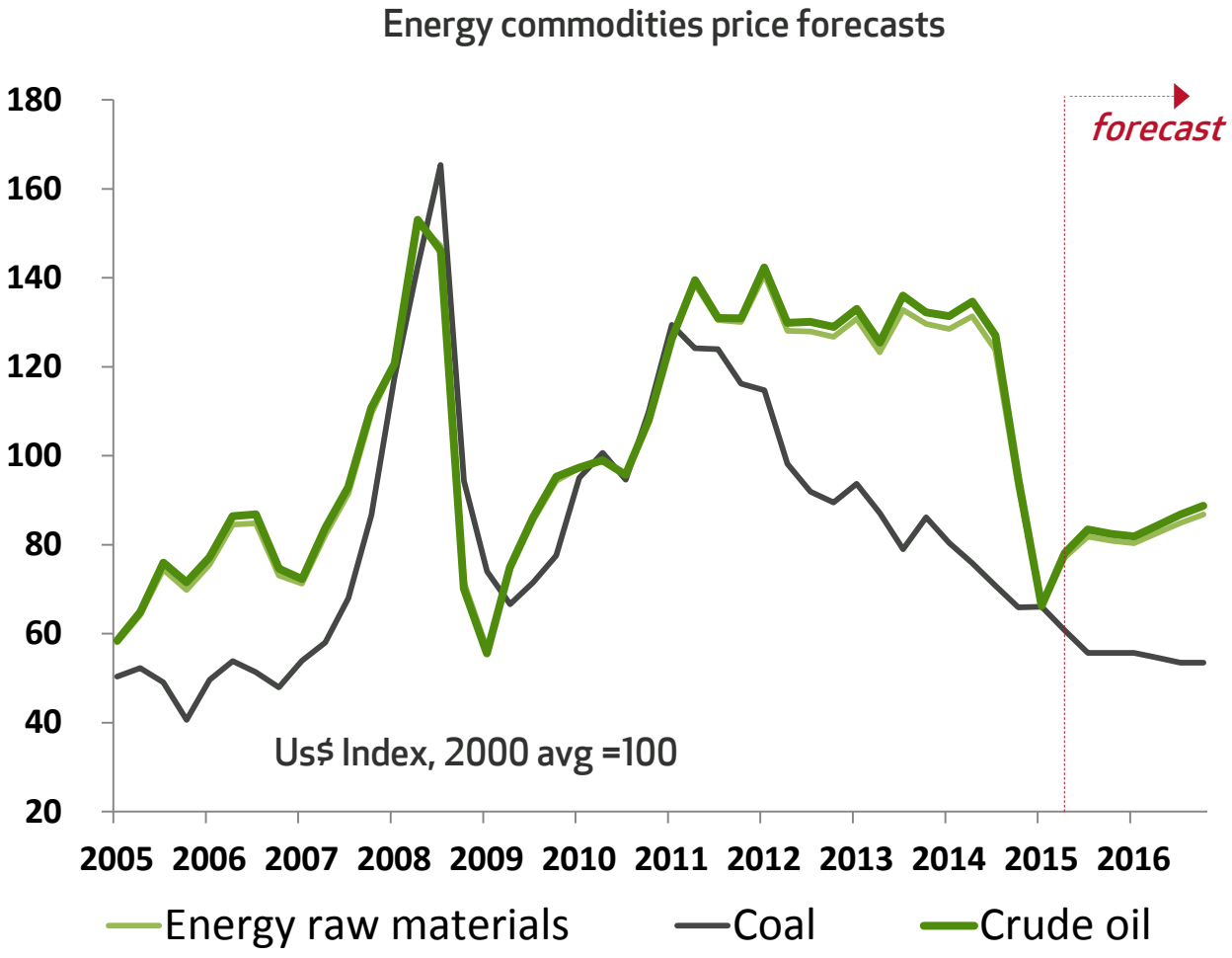
Forecast | Energy complex



Thanks to the low price environment the **overall picture for oil demand should brighten in the coming months**, but we don't expect it to improve considerably, a view confirmed by the International Energy Agency, which projects it to increase by 1 million b / d in 2015.

As a consequence of lower returns on investment for the Us upstream industry, **the Us oil production will soon flatten.** The gap between oil supply and demand could then begin to tighten, leading oil price to converge towards a more sustainable level.

In all likelihood, **the triple digit oil price era is definitely over.** Rather, a Us$ 70-75/barrel bandwidth appears a more reasonable forecast for crude oil.

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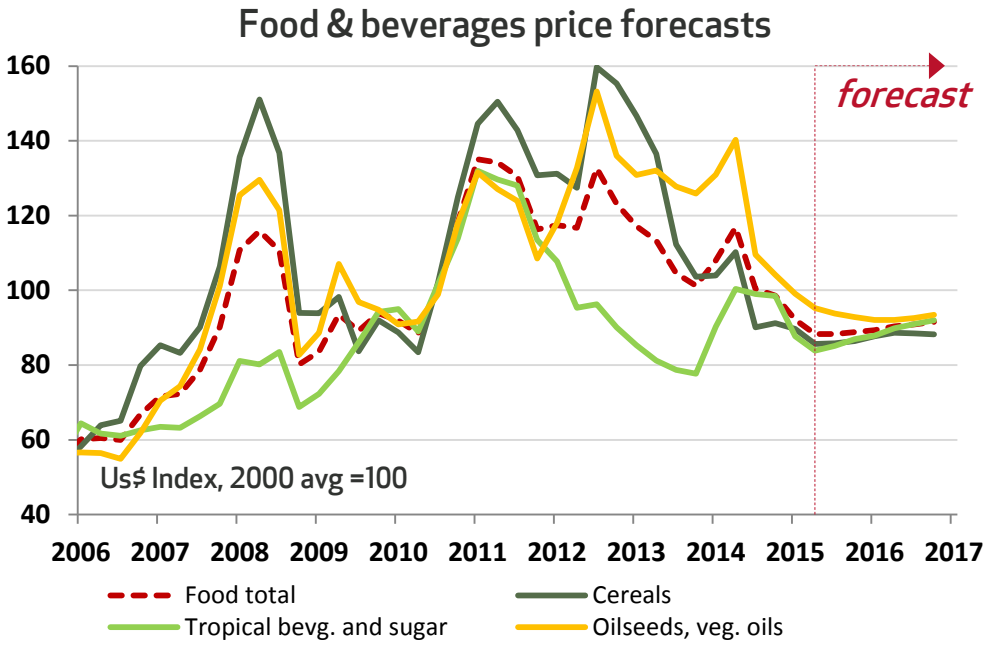
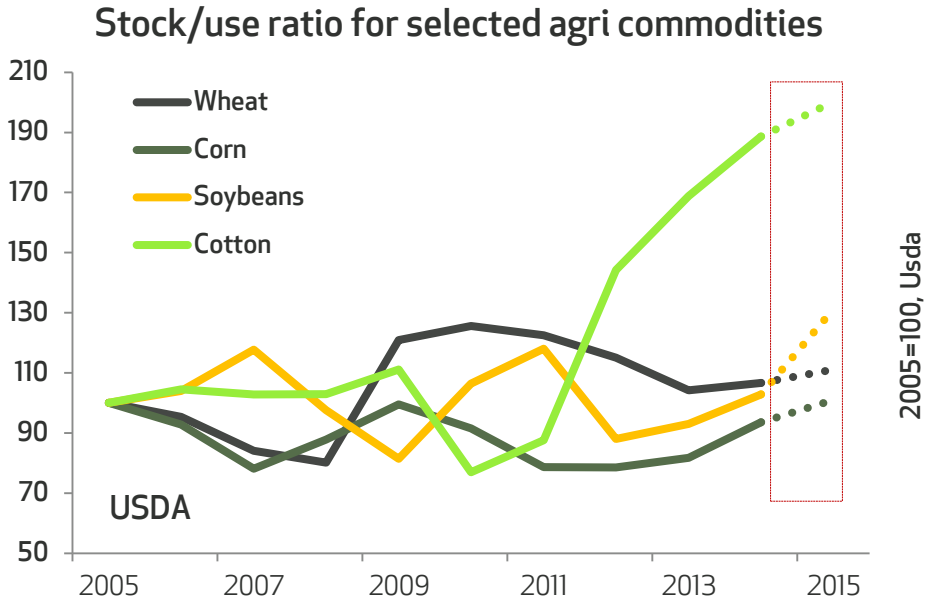
Agriculture | record production depresses prices



Agricultural prices continued their broad-based declines in 2015Q1, **with real food prices not far from 2007 level.** In its April 2015 assessment the U.S. Department of Agriculture maintained its already comfortable outlook for the coming season, further pressuring prices.

Global grain stockpiles are indeed large and growing, suggesting price stability will persist in the coming season. 2015 acreage will confirm generally robust for most of the commodities, even though sooner or later will likely decrease given the farm income decline.

Declining energy and fertilizer cost is another headwind for the agricultural price recovery.



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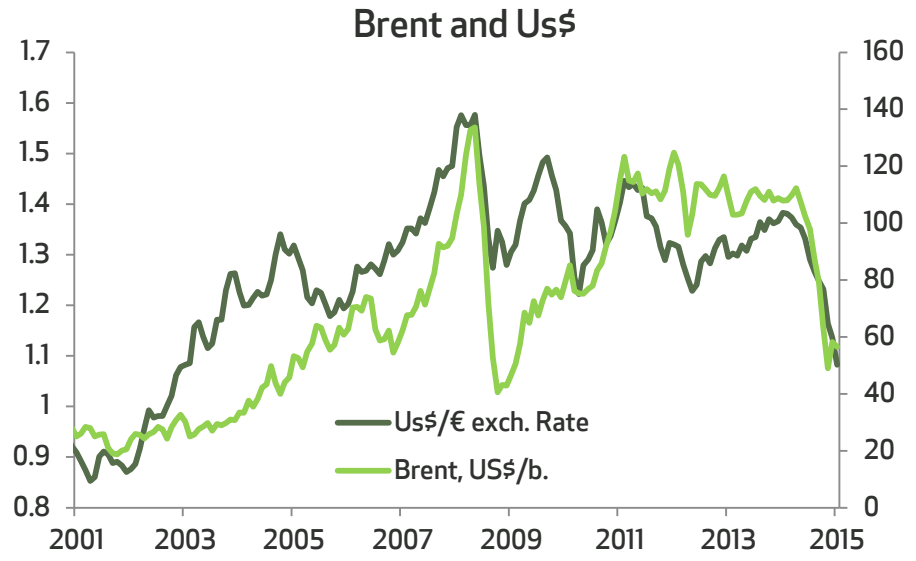
Exchange rates & commodity prices

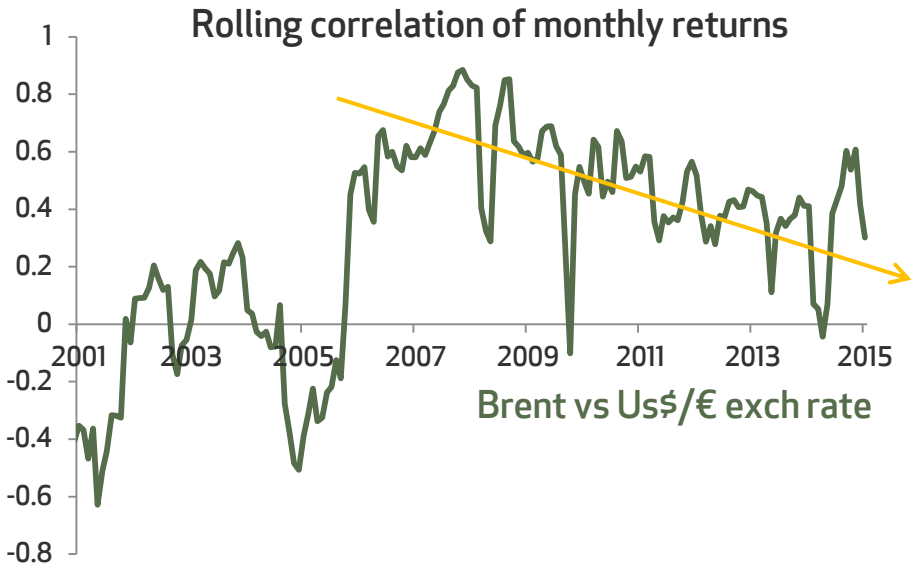
There are several reasons why the value of the dollar has an impact on commodity prices. However, prior to the emergence of the supercycle commodities had no apparent correlation with Us$.

Strong coupling between Usd and commodities occurred in the supercycle years, **when a strong commodity demand rise had not been matched by an adequate increase in supply** (2005-2008). Furthermore, the timing coincides with the emergence of commodity as an asset class, at a time when commodities began to be seen as a protection against infaltion/investment product.

The end of the commodity supercycle marked the start of a structural loosening of this relationship, and the correlation between dollar and commodities reversed towards the pre-supercycle levels.

The oil and other raw materials fall went hand in hand with a rise in Us$ value, however, it's unclear whether the currency movement should be considered a causal factor for the recent commodity slowdown.





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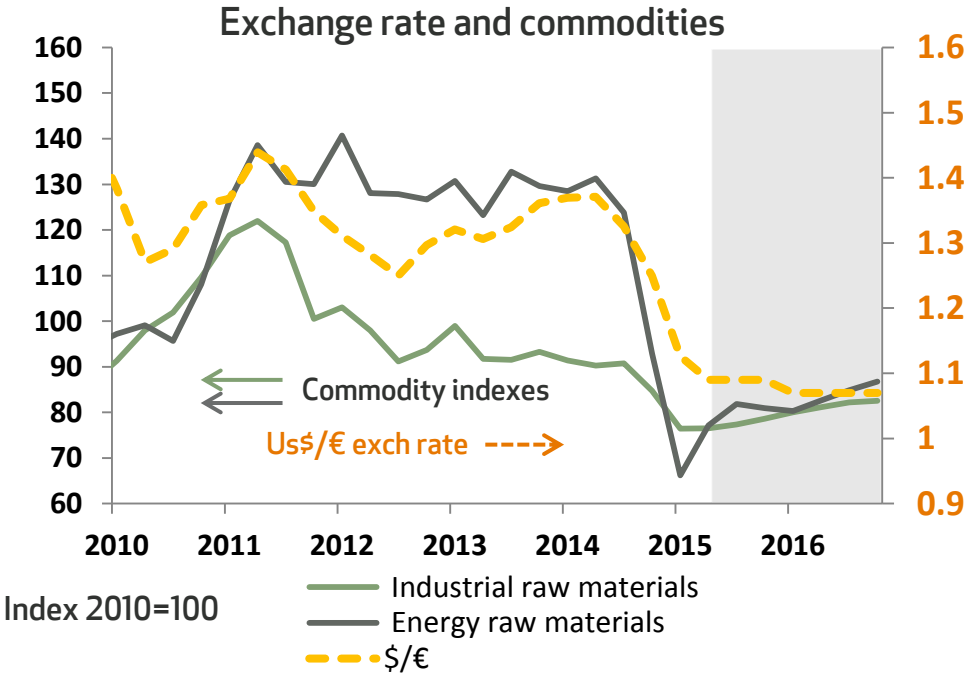
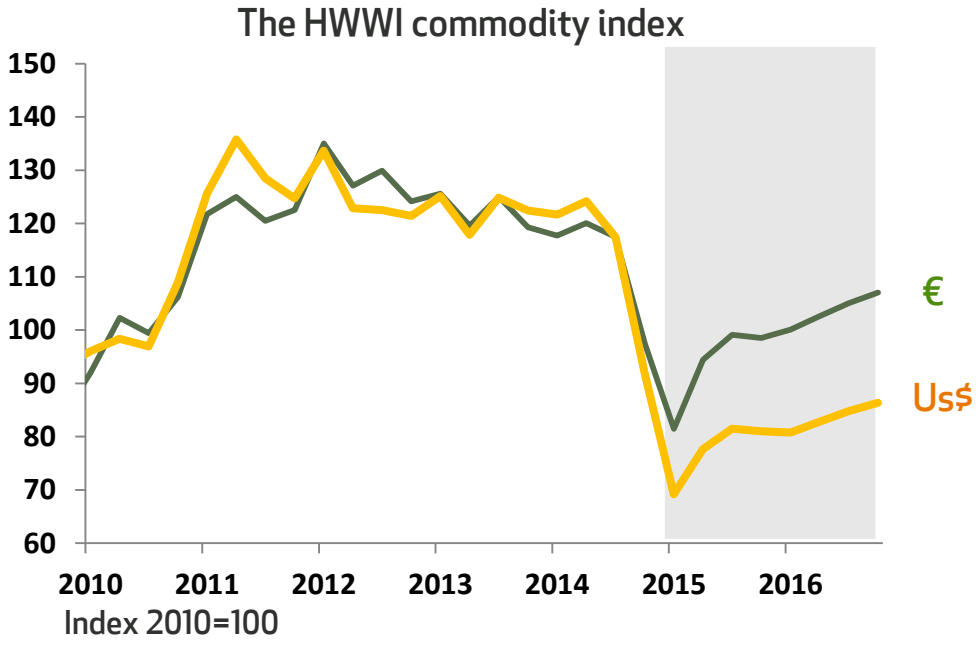
2015-'16 outlook – Exchange rates



Divergent central bank policy increased volatility in currency markets. While the Fed is preparing for policy tightening, globally monetary policy has loosened considerably. The ECB started its bond-buying program at the beginning of this year, and similar measures are expected from the BoJ. This divergence has led to a significant appreciation of the dollar against other currencies. Expectations are for **Us$/€ exch. rate to stay close to parity in the next 2 years.**

Clearly, the vantage for the European manufacturing industry related to the fall of commodity prices will be largely tempered by the large depreciation of € against dollar.



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