Where next for gold and oil?

Thu, 24/02/2011 - 14:37 | Fiona Bond

The continuing violence in Libya and fears the unrest could spread through the Middle East have sent commodities soaring. As governments around the world scrambled to evacuate their citizens from the country following Colonel Gaddafi's warning that he would crush the revolt, investors scurried to the commodities market as a safe haven.
Oil rallied to a 30-month high, stoked by supply concerns in the region, while gold prices smashed through the $1,400 barrier as the crisis deepened.

Oil

Events in the Middle East have sent Brent crude to a two-and-a-half-year high, as the market is gripped in supply panic. Brent Crude shot to as high as $119, up almost 18% since unrest in the region first began.
Harry Tchilinguirian, commodity strategist at BNP Paribas, said: "When geopolitics in the Middle East are at play in the oil markets, all conventional bets on the direction of oil prices based on supply and demand, fundamentals, or economic variables, are off.

"The uncertainty in terms of the developments in Libya, in particular in relation to the size of shut-in production, or rumours of 'force majeure', makes for an oil market that has greater volatility to the upside."
The escalating civil unrest had now led to the evacuation of oil crews and production shut-ins, with one report suggesting that as much as half the North African country's production had been suspended.
British oil giant BP (BP.) confirmed earlier this week that all families and dependants of its Libya-based expatriate employees had been evacuated, while Italian group ENI said it had suspended some operations in the country as a precautionary step. Repsol - one of the largest foreign operators in the country - also announced it had stopped all of its production and exploration activities.

Meanwhile, events in the Middle East have also dramatically caught up with WTI crude oil, sending it over the $100 barrier for the first time since the start of October 2008.

The gap between the Brent and WTI has narrowed in recent days, although analyst Carsten Fritsch at Commerzbank says uncertainty surrounding oil shipments in the Middle East should prevent the prices from coming any close as Brent should continue to benefit from its tighter availability and geographical proximity to the unrest.
Much, of course, depends on how OPEC will tackle the reduction in supply given that Libya plays host to Africa's largest oil reserves.

Fritsch said: "Saudi Arabia reaffirmed [its plans] to expand production in the case of supply shortages. That said, Saudi oil is not a perfect substitute for Libyan oil, as the latter is low in sulphur content and is thus considered to be of higher quality."
Amrita Sen, oil analyst at Barclays Capital, said Brent markets "have flipped into slight backwardation, a trend we expect to continue in the short term, if sourcing immediate supplies is a concern."
Furthermore, there are fears that the unrest could well spread to the Arab country, a fact which seems to be backed up by the Saudi king's announcement of benefits worth $37 billion to calm the people.
Tchilinguirian said: "Supply solutions to outages in Libya, be it through increased production in OPEC, or the release of strategic inventories of the International Energy Agency, will only be event driven and will take time before they reach the market."

As a result, the market expects oil prices to rise further. BNP Paribas has revised its oil price forecast for the second quarter, with WTI expected to average $105 per barrel and Brent forecast to reach $117 per barrel.
Meanwhile, David Murrin, chief information officer of Emergent Asset Management is predicting prices as firm as $200 per barrel.

Sen summed up the general feeling in the market: "It is more than just about lost barrels; it continues to inject a huge amount of uncertainty in the oil market, especially for the medium term, as destabilisation in the Arab world, home to the world's largest oil and gas reserves and production, is of extreme significance."

Gold

Indeed the wrath of firmer oil prices has already been felt across fellow commodity gold, which has seen its allure boosted amid fears that oil prices could lead to further inflation.

It's been a tremendous ride for gold bulls, with the precious metal smashing through the $1,400 barrier to hover at seven-week highs and just 1% shy of its December all-time high.

This marks a sharp departure from the downturn suffered in January, which saw prices slip to the low $1,320s.

Standard Bank analyst Walter de Wet said the support gold has received is "obviously to do with political issues, but I think it's got more to do with rising inflation expectations on the back of the rapidly increasing oil price."

Concerns about rising inflation and the dollar debasement sent prices up to 30% higher last year, striking a high of $1,431 an ounce in early December.

James Moore, an analyst at the TheBullionDesk.com, said: "Gold is poised to challenge December's high. The mix of safe-haven demand, inflation concerns and strong retail demand continues to support higher prices."

Gold has proved an attractive uncertainty hedge, as investors look to shield themselves from the volatility in the equity markets, which saw US indices slump to their lowest point this year.

But while there has been mention that investors may soon seek to lock in their profits, Commerzbank commodity analysts said: "Rising risk aversion and the inflation risks in connection with the oil price trend should provide further upward lift on the fold market in the coming days in our view."

And Tom Winnifrith, fund manager at SF t1ps Smaller Companies Gold Fund, expects gold to hit as much as $2,000 by 2012, stating that once the problems of the Middle East were resolved, gold would continue to gather ground on the back of loose monetary policy in the West.

"If you print vast amounts of new banknotes you get inflation and that is now happening across the globe. Base rates will inch upwards across the West as our leaders pretend to be responsible but real interest rates will stay negative for ages. In other words, there is no advantage in owning paper money over gold.

"As such, gold is heading only one way."