Commodity Update – Minerals and Energy

National Australia Bank

- **Commodity markets have been mixed, but the overall sentiment remains bearish on the back of soft economic data in most regions. On the other hand, signs of improvement in the US economy could help to support commodity demand, but the effect on market expectations for Fed stimulus will create headwinds.**
- **Bulk commodity prices have continued to come under pressure from difficult conditions in global steel markets and plentiful supplies of raw materials. End user demand for steel remains low, and downward revisions to economic growth forecasts suggest little support over the remainder of the year. Anticipated additions to supply capacity this year will further contribute to loosening market balances.**
- **The price of gold has fluctuated with an uncharacteristic degree of volatility over the past two months. The driving force behind the most recent price decline has been rising speculation that the US Federal Reserve will begin scaling back its $85 billion a month of Treasury and mortgage debt purchases.**
- **The Bureau of Resources and Energy Economics' (BREE) latest biannual update on the state of mining, infrastructure and processing facilities projects in Australia has provided further evidence that the peak in mining investment is quickly approaching.**
- **Reflecting ongoing weakness in prices, we have lowered our near-term forecasts for some commodities. We are holding onto our expectation for a modest recovery in demand over the forecast horizon that will help to stabilise prices, but the recovery is likely to be more muted than previously thought.**

Monthly Commodity Prices

Global economic activity has generally underperformed expectations over the past month, both in the advanced economies and across the emerging markets. There has been a clear easing in rate of expansion of world exports and industrial output. While there have been several soft patches in global growth through the last few years, the drivers of these events have been easier to identify (euro-zone crisis, US budgetary pressures etc). It is more difficult to determine the drivers of the current soft patch and therefore more difficult to know how and when business confidence and risk appetites in the financial markets will return. The softness in current activity has prompted us to lower our forecasts for the global economy this month; we see global GDP growth of 3% in 2013, before rising to 3¾% in 2014.

While there are emerging signs that activity in the US economy is improving, much of this has been artificially created via very easy monetary policy settings. Consumer and business spending is picking up and labour market conditions are strengthening, although manufacturing activity is still reasonably subdued. At the US Congressional Testimony earlier in the month, Bernanke indicated that the Fed could begin to taper the pace of asset purchases before the end of this year if the recent improvement in US activity continues. Markets appear to be expecting a pull back in Fed stimulus before the end of this year. While a tapering of quantitative easing (QE) is expected to create headwinds for demand, there is also the risk that central banks will not be able to manage the exit property, particularly in the US, Japan and Europe, given that they have gone to extraordinary lengths to boost demand. The impact of this could be to weaken confidence and spur inflation, which will weaken real commodity prices.

Partial economic indicators suggest that Chinese activity has slowed into the June quarter and there is no indication that conditions will improve in the near term. While data published over the past month or so have come in broadly consistent with expectations, the market has revised expectations lower in response to a run of disappointing outcomes since the beginning of this year. Most activity indicators have been fairly soft in April, including industrial production, manufacturing PMIs (with the HSBC flash PMI showing further deterioration in May) and business investment growth. Exports growth is one of the few strong activity indicators but official data do not align with what is being reported on the receiving end. It also appears that we may have seen the bottom in China's real estate sector with investment and the real estate climate index both showing signs of recovery. The potential de-stabiliser will be the response by authorities to the apparent recovery in the real estate market.

Overall, the general softness in economic activity has seen commodity prices (generally) decline further in May. Weakening demand is working to undermine confidence globally and when combined with increasing global commodities production, is placing considerable downwards pressure on current commodity prices. Bulk commodity prices have softened further, although thermal coal prices appeared to stabilise over May. Energy price movements were mixed in the month. The US-led West Texas Intermediate (WTI) oil price firmed substantially while Brent, which is traditionally linked to European economies, remained largely unchanged at a subdued level. Henry Hub gas prices continued to be influenced by varying weather conditions throughout May, but overall prices were lower. Prices have generally eased across the base metals complex, with growing surpluses pushing metals prices towards their lowest levels since the global financial crisis. Gold prices have also come under renewed pressure, largely reflecting rising speculation that the US Federal Reserve will begin to taper its debt purchase program before the end of this year.

Resources & Energy Major Projects Update

The Bureau of Resources and Energy Economics (BREE) released its latest biannual Resources and Energy Major Projects report on 22 May, outlining the current state of mining, infrastructure and processing facilities projects in Australia. The report provides an update on project developments over the six months from October 2012 to April 2013, a period when concerns about the approaching peak in mining investment were intensifying.

According to BREE, 21 projects reached the **completed** stage in the six months to April 2013, representing $15.3 billion in capital expenditure ($3.4 billion higher than in the previous six months). The total number of **committed** projects fell from 87 in October 2012 to 73 in April 2013. The value of committed projects was broadly unchanged at $268 billion (17.9% of current annual GDP), largely reflecting cost overruns which do not necessarily add to the volume of activity or capacity. In April 2013, 174 projects were at the **feasibility** stage having an estimated investment value of around $232 billion, compared to 171 projects in October 2012 valued at around $281 billion. While the value of minerals and energy investment in the pipeline remains enormous, there has been a sharp reduction in the value of projects at the feasibility stage, providing further evidence that the peak in mining investment is rapidly approaching. Much of the reduction in the value of projects at the feasibility stage reflects projects being reverted back to the publicly announced stage (many already viewed as very unlikely to get off the ground). Nonetheless, it is clear that the degree of uncertainty surrounding the eventual commitment of these projects has risen.

For more details, see: Update on BREE Major Projects

Summary of Price Developments

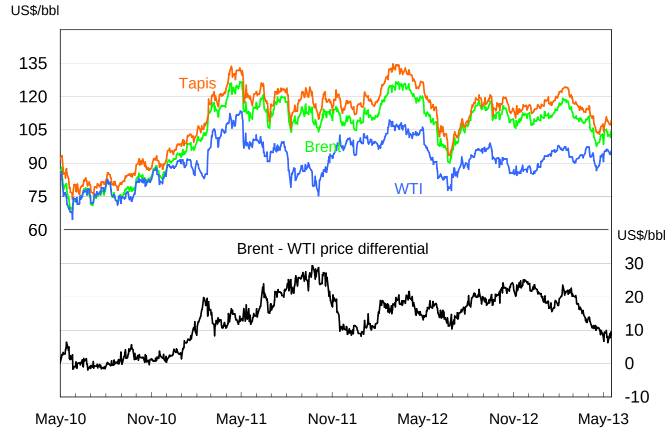
Oil

In May, average oil price indices were mixed, with the US-led West Texas Intermediate (WTI) firming substantially while Brent, which is traditionally linked to European economies, remained largely unchanged at a subdued level. The Tapis index, which can be considered the most relevant to Australia given that we import most of our crude oil from Malaysia, rose marginally in the month. The divergence in the fortunes of the various indices partly reflects the widening gap in the activity outlook of the US and Europe. While partial indicators in the last two months suggest that the recovery in the US is still riddled with challenges and growth remains moderate at best, it is the absence of momentum in the still stricken Euro-zone economy and what appears to be a weakening Chinese growth that is causing the rift.

Average prices of WTI have risen by around 3% in the month, largely due to an upward streak in the first two weeks of the month as updates on the planned new pipeline capacity in the US stoked positive sentiment among analysts on the reduced reliance by the country on imports. Nonetheless, weighing on all indices in general has been a weaker assessment on the Chinese economy, induced by a series of indicators which have consistently surprised on the downside. The most recent Chinese flash PMI, which showed that manufacturing activity has shrunk for the first time in seven months, sent oil indices lower across the board.

Since February, the WTI-Brent gap has narrowed steadily and hit its lowest point since the beginning of 2011. The underlying cause of this had been the announced expansion in the capacity the main Seaway pipeline and the undertaking of a number of pipeline projects which will divert inventories away from the over-supplied distribution hub of Cushing, Oklahoma directly to the refineries in the Gulf Coast. In the past three years, added flows to Cushing from Canada via the newly built Keystone and limited pipeline capacity to move crude from Cushing to Gulf Coast refineries has resulted in the WTI trading at a substantial discount to crudes such as Louisiana Light Sweet and Brent. Until mid-2012, there was only one pipeline which delivered crude oil from the Midwest to the Gulf Coast. Most of these projects are expected to be online by 2014. On the other hand, there has been very little impetus on Brent prices, with a fragile global economic recovery weighing on demand and comfortable supply-side conditions from a restored North Sea production and stable outflows from OPEC members at around 30mbbl/d. OPEC members have yet to resort to any cut in quota in response to what are perceived to be weak Brent prices.

Oil Prices – Daily nominal terms



Source: Thomson Datastream

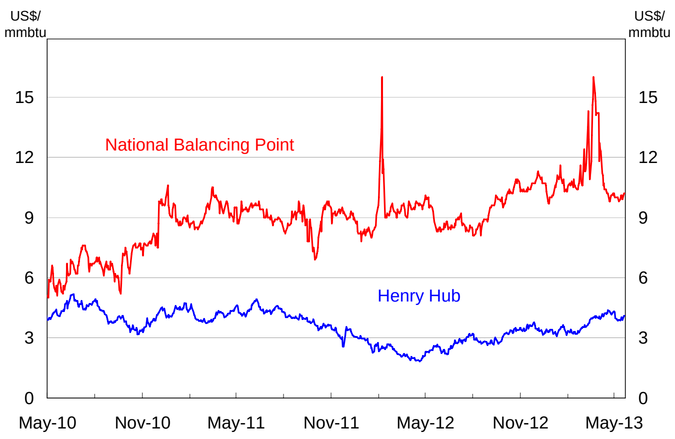
While there had been a few downside surprises in the Euro-zone and Chinese economic indicators which led us to reassess our view of the regions' future growth trajectory, we are beginning to see some green shoots emerging on the demand side of oil. A recent up-tick in the price of gasoline in the US has reminded us that we are entering a seasonally strong quarter of the year, with a higher driving-related and cooling demand in the northern hemisphere. The resumption in operation by a number of refineries across Asia starting April will also benefit crude oil demand and prices. Of course, the elephant in the room remains the high level of global stocks, with the Energy Information Agency (EIA) estimating that OECD commercial oil inventories at the end of 2012 totalled 2.65 billion barrels, equivalent to 57.9 days of supply. Current inventories at Cushing are also well above the maximum of their five-year range.

Taking into account the recent spate of weak global data, EIA has revised down its global demand for 2013 and 2014 to 89.9 mb/d and 91.1mb/d respectively in its latest May short-term energy outlook report, while revising up its forecast on OECD commercial reserves for both years by 1.9% and 1.6% respectively. We have echoed EIA's more downbeat sentiment this month by downgrading our forecasts for Brent and WTI, with the expectations that the gap between Brent and WTI prices will gradually narrow as the capacity of the pipelines to refineries expands. Overall, we see the price of WTI rising to around US$97/bbl over 2013, while the price of Brent is expected to lift to around US$106/bbl by the end of the year.

Natural Gas

The last few months had been marked by some highly interesting developments, some arguably historic, in the dynamics of global natural gas markets. In a landmark move that potentially signals a new era of US energy exports, the US government approved the second application to export liquefied natural gas (LNG) to countries lacking a free trade agreement (FTA) with the US on 17 May, creating scope for the US to play a larger role in the global energy space. The approval of Freeport LNG's facility in Quintana Island, Texas ended nearly two years of delays in processing export permits, which were held up as lawmakers weighed the pros and cons of exporting the nation's newly discovered wealth of natural gas to markets abroad.

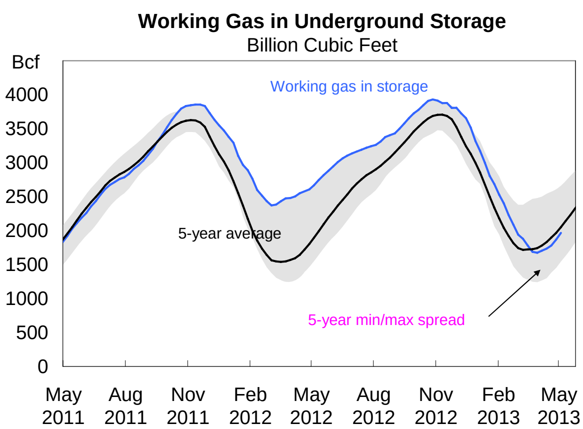
Henry Hub and National Balancing Point Prices



Sources: NAB; Thomson Reuters

US natural gas spot prices were on a broad upward trend through March and most of April, reaching a 20-month high in recent weeks. An unseasonably cold March spurred prices higher after three months of relatively little price growth, as space-heating demand increased through much of the country and led to large storage withdrawals. Prices continued to rise in April as lingering cold in the Midwest kept demand elevated. The Henry Hub spot price averaged $4.17 per MMBtu in April, the highest monthly average price since July 2011. At the beginning of May, US natural gas prices tracked lower as seasonal conditions turned milder. However by the second week of May, dramatic shifts in temperatures in parts of the country to be warmer-than-average steered prices in the opposite direction. That said, the monthly average is lower than that of April, at approximately $4.05, an expected outcome in a period when the northern hemisphere enters the shoulder period between heating demand in winter and cooling demand in summer. Hot and humid temperatures forecast for most parts of the Midwest and East Coast over the second half of May and most of June point to increasing energy demand as homes and businesses turn on air conditioning.

Working gas in underground storage



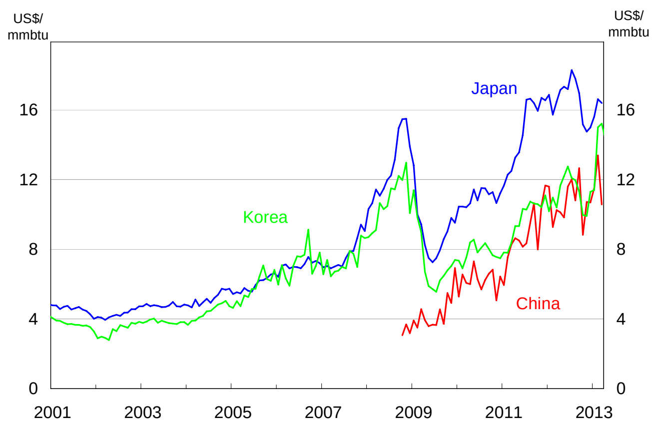
Sources: US EIA

Looking ahead, we anticipate the recent strength in natural gas prices to consolidate going into the US summer. At the moment, summer is forecast to be warmer than average for much of the continental US, which is likely to induce an uplift in cooling demand. Positive global sentiment associated with the imminent liberalisation of the US LNG export market to allow access to its relatively cheap supply by non-FTA partners is also likely to lend some support to prices. Also appearing to support prices is the slowing growth in production and inventory accumulation from their trailblazing pace from late 2011 through most of 2012, with "deficits" – actual monthly underground storage levels – to be below their five-year averages occurring from February to May.

In the UK, natural gas prices have fallen about 4% in April since the advent of the natural gas shortage "scare" that caused the National Balancing Point price to spike to its record high in the second last week of March. Lower Brent oil prices have also served as a factor in the fall. Recognising the potentially significant implications of the US shale gas revolution, European Union leaders have urged faster integration of the bloc's power and natural-gas markets to lower energy prices as the EU's cost gap widens from its largest trading partner, threatening to undermine the EU's industrial competitiveness. If the EU becomes a fully integrated market, it could save as much as 35 billion euros ($45 billion) a year in electricity costs in 2015 compared with 2012, according to the European Commission, the bloc's regulatory arm.

In Asia, the LNG market has broadly turned southwards in March, with the sharpest drop observed in China. In Japan, LNG import prices were down 3.0% in the month although still at a historical high of US$16.40/mmbtu. The notable depreciation of the yen in recent months has resulted in strong upward pressures in the import price of LNG. Korean LNG prices, which follow the lead of Japanese LNG prices, fell 6%. Chinese natural gas prices suffered the most severe fall of 21%. More recently, the downturn in prices in the Asian spot LNG market over March were largely attributable to weak industrial activity in China and softer Brent prices.

Japanese looking for cheaper natural gas for the long term



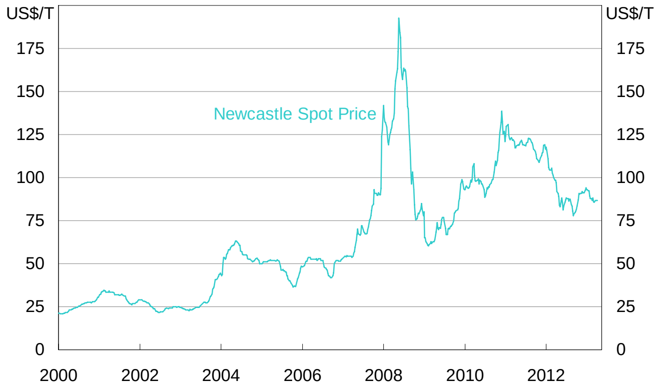
Sources: Thomsons Datastream; CEIC; NAB Economics

The increasing prospect of the US becoming an unrestricted gas exporter has been greeted with enthusiasm by several import-reliant major natural gas markets in Asia, where unsustainably high energy import bills have escalated to become a major issue of national concern. Natural gas trading in the region predominately relies on long-term contracts in which the price of gas is linked, or indexed, to that of oil. However this practice has kept Asian gas prices much higher than those in other markets, to around four times the price paid by North American gas trading hubs. Consequently countries such as Japan and China have launched a number of initiatives, including negotiations with the US government and providing incentives to the energy firms in their respective countries to make inroads into securing relatively cheaper US supplies.

Coal

Coal prices have been mixed over the past month, with Australian steaming coal prices gaining support from lower availability of prompt cargoes, robust energy prices and speculation over China's ban on low quality coal imports. In contrast, coking coal has continued to face headwinds from a softer outlook for the steel industry.

Coal Prices



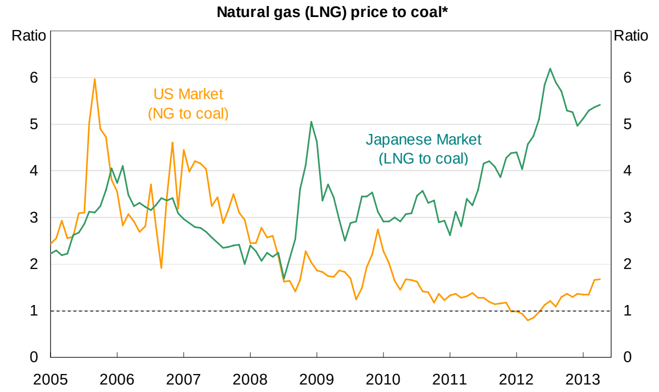
Source: McCloskey's, ABARE, NAB

Spot prices of thermal coal shipped from Newcastle (FOB) were broadly flat in May, following two consecutive months of decline, remaining around US$87 per tonne. At these levels, industry estimates suggest that almost a fifth of global production, and more than a quarter of Australian thermal coal production, is unprofitable. Even at higher contract prices (around 30% of seaborne coal is sold on contract) – settled recently by Japanese utilities at US$95 per tonne – around 20% of Australian production is expected to be running below cash costs. Higher cost production is being shut down in response to falling prices, while expansion plans are also being wound back, downsized or delayed (Update on BREE Major Projects). For example, Glencore Xstrata recently scraped plans for the Balaclava coal terminal development, which was expected to raise shipping capacity by 35 million tonnes per year, citing poor market conditions as a contributing factor.

Cuts to Australian capacity may help to stabilise market balances that have been bolstered by a sharp pick up in US coal exports; rising gas production has weighed on US domestic coal demand. Persistently low prices for natural gas in the northern hemisphere will continue to encourage US coal producers to export into Asian markets. However, US gas prices have been rising recently (see Natural Gas section), improving the attractiveness of thermal coal to buyers and helping to stabilise coal prices. However, the recent announcement permitting US gas exports is expected to bring about more significant declines in global gas prices over the coming year, detracting from coal demand. Therefore, we are likely to see an ongoing trend of electric utilities retrofitting for gas usage.

News of a proposed ban of low quality coal imports in China – minimum 4540 kcal/kg and maximum sulphur and ash content of 1% and 25% respectively – could have big implications for the global market. While such a policy would have negative consequences for low quality coal producers such as Indonesia, it may simultaneously work to benefit higher quality produces like Australia, although such a result is not assured. The ideal outcome for Australian producers is if the restriction were to push China's domestic coal prices higher, bolstering demand for higher quality imports.

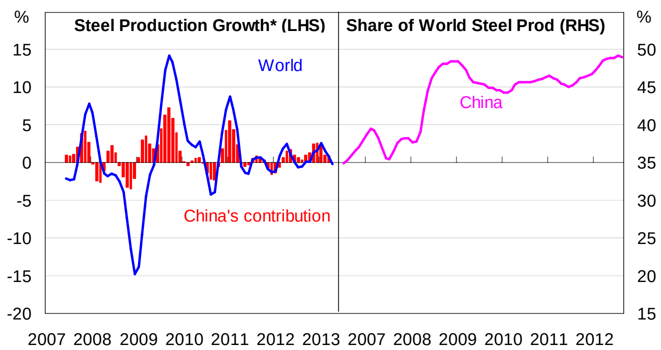
Price competitiveness of thermal coal



* Proxies for each region converted to USD/MMBTU
Sources: Bloomberg, NAB

Steel demand has remained subdued, adding to the pressures facing steel producers and weighing on prices for raw materials used in production. Steel prices have fallen further amid weak demand and high (albeit declining) steel inventory levels. Shanghai rebar prices fell 2½% in May and are currently around 12% below this years peak. Steel production has been slow to respond, but growth has now slowed to be broadly flat over the three months to April. More timely data from the China Iron and Steel Association (CISA) show that the production rate in mid-May remained at a healthy 2.185 million tonnes per day (down from a record 2.193 million tonnes earlier in the month). The slow adjustment has seen inventories build to record highs this year, although we are now starting to see some de-stocking take place. Inventory levels of five major steel products (including rebar) remain high, exceeding 18 million tonnes in late-May, but are around 13% below the record high of early April.

Chinese Steel Market Conditions



* Calculated as the 3month/3 month percentage change of seasonally adjusted steel output.
Source: World Steel Association, NAB

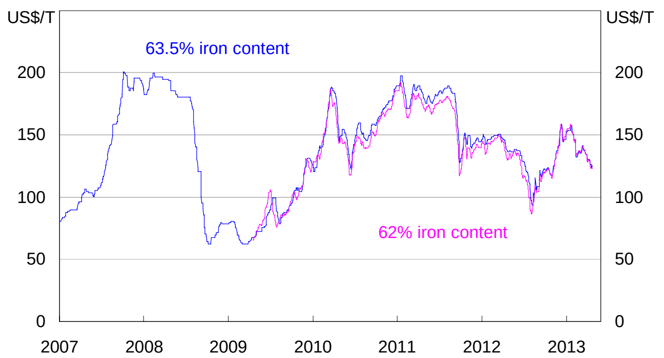
With Chinese authorities voicing their intention to hold back on policy stimulus, and accept a slower pace of economic growth, we are unlikely to see a material improvement in steel demand until later in the year as the global economy improves. Hopes that urbanisation in China will still work to support steel demand have been tested by delays in the release of the government anticipated urbanisation development plan from the National Development and Reform Commission. Reports have suggested that a draft submitted by the NDRC was recently rejected by Premier Li Keqiang, but the NDRC continues to anticipate a 2013 release.

Falling steel prices have forced producers to lower raw material costs. Consequently, coking coal prices have trended lower as mills look to use lower quality coal in preference to hard coking coal. Average spot prices for premium hard coking coal in May fell further from last month to US$142.3 per tonne FOB – well below the reported US$172 per tonne (FOB) contract price set for the June quarter between BMA and Japanese steel producers. Nevertheless, supply appears to be responding and at current benchmark prices, some industry estimates suggest that up to 20% of global production capacity could be uneconomic. With spot prices now well below the Q2 benchmark, we are likely to see further capacity reductions that should help to stabilise prices. Under old contract formulations, spot prices are pointing to a Q3 contract price of around US$150 per tonne (FOB), which is the lowest contract price since 2009/10.

Iron Ore

Iron ore prices have recently dipped back well below US$120 per tonne (CFR, Tianjin) to their lowest levels in almost 8 months; declining 16% since the start of May. All up, iron ore prices have now fallen by almost 30% from their peak in late February, easing to below US$112 per tonne (CFR). The average price for iron ore (62 per cent) is estimated to have been around US$117 per tonne (FOB) in May. Recent declines in prices are attributed to weaker demand due to the softer steel outlook – including headwinds from Chinese policy measures – that has seen steel mills attempt to destock iron to reduce costs.

Chinese Iron Ore Prices*



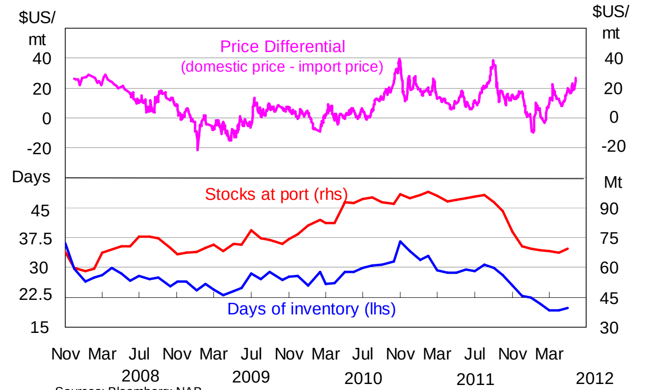
* Includes the cost of freight
Source: Bloomberg, Thomson Datastream

Although Chinese iron ore imports rose around 4% in April, declining steel demand and prices saw larger steel mills resell some iron ore cargoes back into the market. Estimates from earlier in the month suggest that around 2-3 million tonnes of ore bought under long term contracts were redirected into the spot market, contributing to the decline in ore prices. Nevertheless, Iron ore stockpiles at ports remain low relative to history and production levels, although this is partly a reflection of the stubbornly high rates of Chinese steel production – disregarding the adverse demand conditions. The Chinese stock-to-use ratio implies that there are approximately 20 days of iron ore currently available. However, given the uncertain outlook for steel demand, mills and traders are probably content to hold lower stock piles to avoid storage costs, limiting any support from restocking activity in the near term. Similarly, planned maintenance at Chinese mills in June will cap necessary holdings of iron ore and will provide yet another headwind to iron ore prices.

Aside from planned maintenance, steel production is likely to slow over coming months to reflect the persistently lower steel prices and elevated stock levels. However, on a slightly more upbeat note, the iron ore arbitrage window has become more positive of late which may trigger some renewed interest in seaborne iron ore.

In the longer term, market balances are expected to loosen further as planned capacity expansions come online (in regards to Australian capacity). Consequently, we expect to see iron ore prices dip to US$100 per tonne (FOB) some time next year, if not sooner.

Chinese Iron Ore Stocks at Port



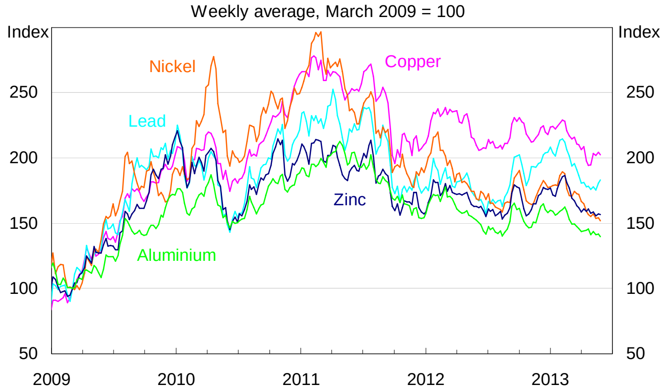
Sources: Bloomberg; NAB

Base Metals

Prices have generally eased across the base metals complex over the past month, reflecting a softening in Chinese activity data and heightened speculation that the US Federal Reserve will begin tapering the pace of asset purchases before the end of this year if the recent improvement in US activity continues. Both Chinese and US manufacturing PMI indicators have underwhelmed markets, not boding well for near-term metals demand. In aggregate, base metals prices on the London Metals Exchange (LME) have eased by 2% over May to date, consolidating a 5% fall over April, to be around 8% lower over the year.

Base Metals Prices

Weekly average, March 2009 = 100



Sources: NAB; Thomson Reuters

Base Metal Prices

	Avg Price (US$/tonne) May-13	Monthly % change May-13	May-12 - May-13 % change
Aluminium	1828	-2	-9
Copper	7246	0	-8
Lead	2018	0	1
Nickel	14968	-4	-12
Zinc	1826	-2	-5
Base Metals Index		-2	-8

* Prices on an LME cash basis. May to date.
Sources: LME; NAB

It appears that demand-side factors remain firmly in the driver's seat, with growing surpluses pushing metals prices towards their lowest levels since the global financial crisis. The average price of **nickel** for May was around 4½% below its April average. The sharp deterioration in price largely reflects the global supply glut that is forming as a result of a lack of demand from Japan – the metal's third-largest user. Furthermore, a surge in the production of nickel pig iron, a substitute for low-grade ore, has seen Chinese stainless steelmakers lower their consumption of nickel. **Aluminium** and **zinc** prices were between 1-2% lower compared to their April averages, while lead prices were off ½%. **Copper** was the best performer, with average prices broadly steady in the month. Copper prices may have been supported by a tunnel collapse at Freeport's Grasberg mine in Indonesia – the third largest copper mine in the world – which halted production for the last two weeks of May and raised supply concerns (see also Gold section below).

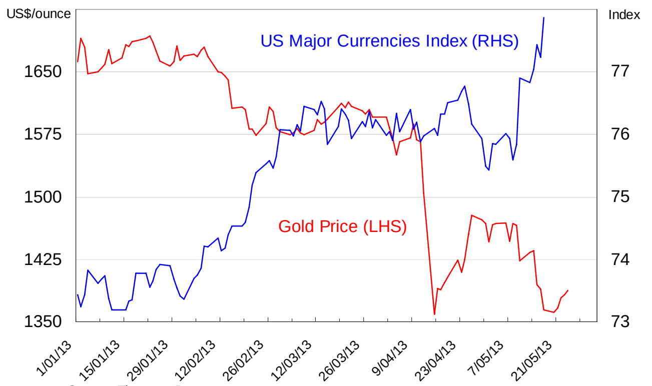
While the US economy is showing signs of improving, the industrial sector continues to languish, to be consistent with the general theme across the other major economies. The weakness in the industrial sector has led to further building of copper and nickel stocks at LME warehouses, although new copper additions have slowed from the rapid pace seen in March. LME stocks of lead and zinc have gradually declined, though remain at elevated levels. The build up in aluminium stocks appears to have peaked, but the overall volume of stocks remains extremely high. Overall, the volume of Chinese aluminium stocks has begun to decline, after lifting continuously since the middle of last year. Copper stocks, which experienced a less pronounced rise over the past year, have also begun their descent, though they remain elevated. Zinc stocks continue to be drawn down, and are currently at levels last seen in late 2010. High stock levels are limiting any upside to physical prices, although the low interest rate environment, further monetary easing and steep contango are working to bolster financial sector appetite for metals (which may see inventories trend higher). The resurgence in cancelled warrants for some metals has continued throughout May, suggesting a temporary spike in physical demand. In particular, lead and copper have seen a sharp increase in cancellations in recent weeks, which appear to have (temporarily) reduced metal availability to consumers and provided some support to prices. Whether this is sustainable is yet to be seen.

The global economy has invested heavily in base metal mines over recent years and it is anticipated that the investment yield will ramp up, culminating in a surplus supply of metals this year. This pick up in production is expected to be the main driver of metals prices over 2013. Surging stockpiles of metals – particularly those held in Chinese warehouses – are signalling weakness in end-user demand in the near term and are likely to cushion metals markets and prevent an abrupt recovery in prices once demand improves. We have revised our nickel forecasts lower in response to the greater than expected decline in May and the anticipated rise in nickel stockpiles in response to Chinese steelmakers substituting towards nickel pig iron. We have left our other metals forecasts broadly unchanged.

Gold

The price of gold has fluctuated with an uncharacteristic degree of volatility over the past two months. After slumping to a new low of $1,336 an ounce in mid April, the price recovered partially as buyers entered the market to take advantage of relatively low prices. After stabilising at around $1,460 an ounce towards the end of April and into early May, the gold bears re-emerged and prices quickly fell back to recent lows. The driving force behind the most recent price decline has been rising speculation that the US Federal Reserve will begin scaling back its $85 billion a month of Treasury and mortgage debt purchases. At last week's Congressional Testimony, Ben Bernanke said "if we see continued improvement and we have confidence that that's going to be sustained then we could in the next few meetings… take a step down in our pace of purchases". The belief that the Fed has a "conditional bias to taper" the pace of asset purchases before the end of this year largely reflects a recent improvement in US activity. The slightly better outlook for the US economy has increased demand for riskier assets and subsequently reduced demand for safer assets, such as gold. Some (slight) upwards pressure has been applied to the price of gold since the middle of May, possibly reflecting heightened supply concerns following the tunnel collapse at Freeport's Grasberg mine in Indonesia, which is the largest gold mine in the world. Over May to date, the price of gold is around 5% lower than the average price over April.

Gold Price and the US Dollar (Daily)



Source: Thomson Datastream

Extremely low interest rates, a flood of stimulus from the US Fed and a heightened degree of uncertainty about the outlook for the global economy have all helped to boost the price of gold over the past three years. More recently, gold's lustre has been tarnished as a result of an improving US economy and better consumer sentiment, which has seen demand for riskier assets become more heavily entrenched. The rapid appreciation in the US dollar – as a result of the improving economy – has also increased the attractiveness of holding US currency and treasury bonds relative to gold assets. As a result of the shift in gold demand fundamentals over recent months, money managers have been aggressively cutting their net-long positions, with holdings in May falling to the lowest levels since July 2007.

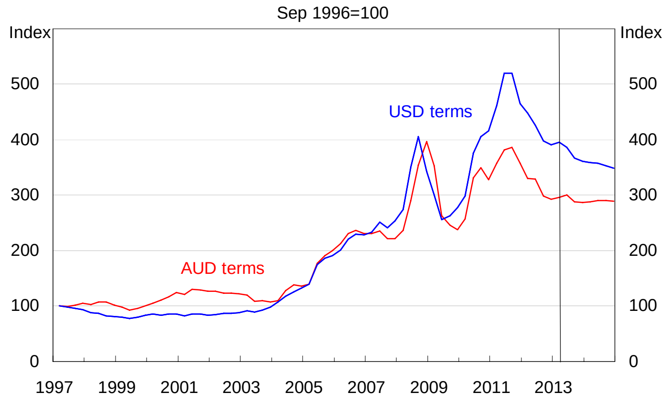
Despite market sentiment turning bearish on the outlook for gold, physical demand has picked up more recently with gold buyers taking advantage of relatively low prices. In April, the US mint sold 209,500 ounces of gold coins, which was the most since December 2009. Physical demand, especially in Asia, has also been very supportive. Given the central role gold plays in the Indian domestic economy, the Reserve Bank of India reacted to the sharp price declines by increasing premiums for physical gold imports from 3% to 6% in mid-May. While this reform is anticipated to impact gold imports in the near term, it is not expected to significantly impact Indian demand in the longer term. Central banks continue to purchase gold, helping to boost demand as central banks look to expand their reserve asset holdings.

While the tapering of the US Federal Reserve's bond buying program is inevitable, we expect a stimulus to remain in place for the remainder of this year and into 2014 providing continued support to the price of gold. We also expect the trend of central bank gold buying to continue, especially in the emerging economies; the World Gold Council is predicting that central banks may buy as much as 550 tonnes this year after adding 534.6 tonnes in 2012. While physical demand is expected to remain supportive, offsetting risks remain prevalent, with soft inflation in the advanced economies and a shift in demand towards better performing equities likely to weigh further on prices. We expect gold's final resting place at the end of 2013 to be around US$1,410 an ounce, which is below levels recorded at the end of last year (gold averaged US$1,684 an ounce in December 2012). Looking further ahead, we generally expect the price to moderate to around US$1,310 an ounce by the end of 2014, as growth in the major advanced economies regains momentum and investors increase their demand for riskier assets.

Outlook

The softness in demand from major advanced economies and the emerging markets continues to hamper activity in commodities markets. Prices of minerals and energy commodities have generally fallen in May, largely reflecting the softness in demand from the US, Japan and Europe. Furthermore, speculation that the Fed will begin to taper its asset purchases later this year has kept markets wary of the strength of the potential recovery in the world's largest economies. While the Chinese economy has experienced some weakness over recent months, it is anticipated that growth will improve in the second half of this year, assisted by the objective of the new leadership team to maintain stability. Despite the anticipated near-term support from various authorities, the balance of risk remains to the downside, and we have revised some of our price forecasts for the industrial commodities lower this month. The potential for a sharp (policy induced) correction in Chinese real estate remains a possibility. On a more positive note, there are signs that activity in the US may be improving in response to very easy monetary conditions. In the face of uncertain demand, robust supply growth will see conditions in many commodity markets loosen over the outlook period, helping to drive prices lower.

NAB Non-Rural Commodities Price Index



Sources: ABARES; ABS; Bloomberg; NAB; Thomson Reuters

In US dollar terms, the NAB non-rural commodity price index fell by around 16% over 2012. We are expecting another decline of around 7½% in 2013, before falling by 3½% over 2014 (see Graph). Given our forecast for the AUD/USD to soften over the remainder of the forecast horizon, AUD prices are expected to fall by 2% through the year to December 2013, before rising by around ½% over 2014. In aggregating the index, iron ore, thermal coal and metallurgical coal have a combined weight of around 55%.

james.glenn@nab.com.au
alexandra.knight@nab.com.au
vyanne.lai@nab.com.au
rob.brooker@nab.com.au

Quarterly Price Profile

Oil Price Forecasts – Quarterly Average

	Actual	Forecasts							
	Mar-13	*Jun 13*	*Sep 13*	*Dec 13*	*Mar 14*	*Jun 14*	*Sep 14*	*Dec 14*	*Mar 15*
Brent US$/bbl	113	103	105	106	105	106	105	104	104
WTI US$/bbl	94	93	95	97	99	98	95	94	94
Tapis US$/bbl	118	108	110	112	111	111	110	109	110

Sources: NAB Economics; RACQ; Thomson Datastream

*Estimate only; full quarter not yet available

Natural Gas Price Forecasts – Quarterly Average

	Actual	Forecasts							
US$/mmbtu	Mar-13	*Jun 13*	*Sep 13*	*Dec 13*	*Mar 14*	*Jun 14*	*Sep 14*	*Dec 14*	*Mar 15*
Henry Hub	3.49	4.15	3.90	4.20	4.40	4.50	4.30	4.35	4.40
Japan LNG	16.21	15.75	14.80	15.00	15.20	14.50	14.00	14.00	13.50
Brent Oil	113	103	105	106	105	106	105	104	104

Source: Datastream, CEIC, NAB Economics

Quarterly Contract Price Profile ($US/T)

	Actual	Forecasts							
	Mar-13	*Jun-13*	*Sep-13*	*Dec-13*	*Mar-14*	*Jun-14*	*Sep-14*	*Dec-14*	*Mar-15*
Iron Ore*	127	122	110	110	105	103	100	100	100
Hard Coking Coal	165	172	150	155	165	170	170	160	160
Semi-soft Coking Coal	116	121	105	105	110	115	115	105	105
Thermal Coal	115	95	95	95	95	95	95	95	95

Source: NAB

* Calculated using weighted average of quarterly lag formulation and spot prices. Weights reflect industry information on ongoing composition changes to the contract porfolios of major Australian miners.

Base Metals Price Forecasts – Quarterly Average

	Actual	Forecasts							
US$/MT	Mar-13	*Jun-13*	*Sep-13*	*Dec-13*	*Mar-14*	*Jun-14*	*Sep-14*	*Dec-14*	*Mar-15*
Aluminium	2000	1880	1910	1940	1970	2000	2030	2060	2100
Copper	7918	7210	7210	7280	7390	7420	7460	7500	7500
Lead	2290	2130	2140	2150	2170	2180	2200	2220	2230
Nickel	17296	15130	15590	15820	15860	15900	15980	16060	16180
Zinc	2029	1900	1900	1910	1920	1940	1950	1970	1990
Base Metals Index	304	280	280	280	290	290	290	290	290

Sources: Thomson Reuters; NAB Economics

Gold Price Forecasts – Quarterly Average

	Actual	Forecasts							
	Mar 13	*Jun 13*	*Sep 13*	*Dec 13*	*Mar 14*	*Jun 14*	*Sep 14*	*Dec 14*	*Mar 15*
Gold - US$	1632	1430	1430	1410	1380	1360	1330	1310	1300
Gold - AU$	1571	1430	1450	1430	1420	1410	1400	1390	1410

Sources: Thomson Datastream; NAB

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics

Rob Henderson
Chief Economist, Markets
+61 2 9237 1836

Spiros Papadopoulos
Senior Economist
+61 3 8641 0978

David de Garis
Senior Economist
+61 3 8641 3045

FX Strategy

Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Emma Lawson
Senior Currency Strategist
+61 2 9237 8154

Interest Rate Strategy

Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Rodrigo Catril
Interest Rate Strategist
+61 2 9293 7109

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Ken Hanton
Senior Credit Analyst
+61 2 9237 1405

Equities

Peter Cashmore
Senior Real Estate Equity Analyst
+61 2 9237 8156

Jenny Khamphet
Senior Real Estate Equity Analyst
+61 2 9237 9538

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Mike Jones
Currency Strategist
+64 4 924 7652

Kymberly Martin
Strategist
+64 4 924 7654

UK/Europe

Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44 207 710 2993

Gavin Friend
Markets Strategist
+44 207 710 2155

Tom Vosa
Head of Market Economics
+44 207 710 1573

Simon Ballard
Senior Credit Strategist
+44 207 710 2917

Derek Allassani
Research Production Manager
+44 207 710 1532

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Tom Taylor
Head of Economics, International
+61 3 8634 1883

Rob Brooker
Head of Australian Economics
+61 3 8634 1663

Alexandra Knight
Economist – Australia
+(61 3) 9208 8035

Vyanne Lai
Economist – Agribusiness
+(61 3) 8634 0198

Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Property
+(61 3) 8634 4611

Brien McDonald
Economist – Industry Analysis
+(61 3) 8634 3837

Gerard Burg
Economist – Industry Analysis
+(61 3) 8634 2778

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

James Glenn
Economist – Asia
+(61 3) 9208 8129

Tony Kelly
Economist – International
+(61 3) 9208 5049

Important Notices

Disclaimer: This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it. Products are issued by NAB unless otherwise specified.

So far as laws and regulatory requirements permit, NAB, its related companies, associated entities and any officer, employee, agent, adviser or contractor thereof (the "**NAB Group**") does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("**Information**") is accurate, reliable, complete or current. The Information is indicative and prepared for information purposes only and does not purport to contain all matters relevant to any particular investment or financial instrument. The Information is not intended to be relied upon and in all cases anyone proposing to use the Information should independently verify and check its accuracy, completeness, reliability and suitability obtain appropriate professional advice. The Information is not intended to create any legal or fiduciary relationship and nothing contained in this document will be considered an invitation to engage in business, a recommendation, guidance, invitation, inducement, proposal, advice or solicitation to provide investment, financial or banking services or an invitation to engage in business or invest, buy, sell or deal in any securities or other financial instruments.

The Information is subject to change without notice, but the NAB Group shall not be under any duty to update or correct it. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

The NAB Group takes various positions and/or roles in relation to financial products and services, and (subject to NAB policies) may hold a position or act as a price-maker in the financial instruments of any company or issuer discussed within this document, or act and receive fees as an underwriter, placement agent, adviser, broker or lender to such company or issuer. The NAB Group may transact, for its own account or for the account of any client(s), the securities of or other financial instruments relating to any company or issuer described in the Information, including in a manner that is inconsistent with or contrary to the Information.

Subject to any terms implied by law and which cannot be excluded, the NAB Group shall not be liable for any errors, omissions, defects or misrepresentations in the Information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the Information. If any law prohibits the exclusion of such liability, the NAB Group limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

This document is intended for clients of the NAB Group only and may not be reproduced or distributed without the consent of NAB. The Information is governed by, and is to be construed in accordance with, the laws in force in the State of Victoria, Australia.

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

United Kingdom: If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated by the Australian Prudential Regulation Authority. Authorised in the UK by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority.

Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

USA: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

Hong Kong: In Hong Kong this document is for distribution only to "professional investors" within the meaning of Schedule 1 to the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) ("SFO") and any rules made thereunder and may not be redistributed in whole or in part in Hong Kong to any person. Issued by National Australia Bank Limited, a licensed bank under the Banking Ordinance (Cap. 155, Laws of Hong Kong) and a registered institution under the SFO (central entity number: AAO169).

New Zealand: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person’s particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. National Australia Bank Limited is not a registered bank in New Zealand.

Japan: National Australia Bank Ltd. has no license of securities-related business in Japan. Therefore, this document is only for your information purpose and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.