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POLICY: FED EXPECTED TO LIFT RATES ON WEDNESDAY

But several policymakers remain concerned that the market is moving in the wrong direction.

The Federal Reserve is expected to proceed with tightening monetary policy this week, even after the recent, poor inflation readings, driven by the stronger hiring. The Federal Open Market Committee might shortly decide to increase rates for a second time this year, lifting the target range for the federal funds rate by a quarter point to 1 per cent to 1.25 per cent. In parallel, the central bank plans to update a statement of its approach to "normalisation" of monetary policy. Areas to cover include its strategy for reducing the size of its USD 4.5 Tn balance sheet by eliminating the reinvestment of proceeds of maturing securities in its portfolio.

During March and April, signs suggested that the US economy was moving in the wrong direction, mainly regarding inflation, and hiring remained below analysts' expectations in May. But Ms Yellen seems convinced that the US is approaching full employment, which will have to push inflation back to the central bank's 2 per cent target. The Fed stated that most policymakers would support a rate increase "soon" with the economy staying on track. As a result, a quarter-point rate increase is likely to be announced on Wednesday. However, the concern remains among several policymakers about inflation's stubborn refusal to accelerate. And if inflation proves to disappoint in the second half, the calls for the Fed to rethink will grow.

Soft inflation might not be enough for Fed policymakers to move far away from their March forecast, which suggests that there will be three rate rises this year, including the move in March, but the scenarios now include the so-called dot plot of rate forecasts for any downward drift in 2018 and 2019. During the crisis the Fed cut rates to near zero, and expanded its balance sheet by USD 3.5 Tn by buying treasuries and mortgage-backed securities. Its current holdings at roughly USD 4.5 Tn include USD 2.5 Tn of treasuries and USD 1.8 Tn of mortgage-backed securities.

The Fed is expected to start reducing that balance sheet this year, with policymakers looking ready to update their principles and plans for balance sheet "normalisation". This meeting might only end in an affirmation that the Fed will use short-term interest rates as its primary tool for steering the economy. The backed strategy of phasing out reinvestment of the proceeds of maturing securities would involve the announcement of steadily increasing caps on the amounts of securities allowed to run off. Of great importance are the timing or conditions of the balance sheet reduction, the size of the caps on the amount of securities to run off, and the time before the caps reach their final level.

The Fed stated that the balance sheet reduction won't start before the interest rates are lifted close to 3 per cent. But there is concern about the delays linked to the risk of a market-shaking debt ceiling showdown this autumn. It's critical if and how the "normalised" balance sheet of the Fed will happen after the reduction of its asset holdings over the past years. The size of it is affected by the mechanism that the Fed will use to set future rates and the quantity of reserves commercial banks want to hold at the central bank.

Source: FT

DRY CARGO: CONSTRUCTIVE SMOOTHING

A look at the accuracy of Chinese data as it relates to the commodity markets.

In most large-scale economies, the official statistics for economic development and progress are fairly reliable, giving analysts and market observers as good an overview of what's going on as can be reasonably expected. Errors in measurement and estimation are of course to be expected in every statistical database, but such errors tend to be made in good faith and be of a non-critical nature.

Yet for the country where accurate statistics arguably matter the most in the current economy, China, market observers have for years had to settle with the notion that any number coming out of China is polished and tailored to suit whatever the central government wants to project; usually steady and unfaltering growth. However, while the central government statisticians claim to adjust their national indicators to take into account over- and under-reporting by individual provinces, as well as smoothing quarterly data to give the impression of steady growth with low volatility, local tampering with the underlying economic data is a problem which also affects China's understanding of its own economy.

In a recent statement, China's Central Committee for Discipline Inspection pointed to falsified data by "some regions" or companies in the coal-rich Inner Mongolia and the grain-producing province Jilin. While the specific nature of the criticism points to what the CCDI calls an insufficient embrace of the "four consciousnesses", or rather the ideological belief in the country's leader, further evidence of tampering with data adds to the uncertainty surrounding China's true economic growth, and the extent to which it has been hit by the slump in commodities.

Having spoken to steel mills and coking coal traders in China, it is clear that demand for these commodities remains much firmer than what could be suspected given an outside view of the statistical trends, yet even to them, the fact that much of China's steel industry suffers from inadequate reporting and overlapping statistics creates uncertainty as to the true volume of steel products produced.

The general view among Chinese industry participants in the steel sector is that correcting this under-reporting of steel products will be difficult, yet the recent criticism from the Chinese anti-corruption watchdog, an organisation under the Communist Party, means that faking data could be taken as a breach of party rules. This should therefore be considered a very strong signal that tampering with data will be treated as a very serious offence.

While Chinese official data should be considered guiding figures for the foreseeable future, it is important to remember that the reasons behind such tampering usually lie in the need for underperforming entities, such as struggling coal mines in Inner Mongolia, to justify their own existence. When the markets enter a slump therefore, one should expect a greater level of what may be called a "constructive smoothing" of official data. Definitely at a local level, and most probably at an official national level too.

Sources: Affinity Research, FT

GAS: INSTABILITY IN THE MIDDLE EAST CAUSES UNCERTAINTY

Initial diversions are causing a stir in the market.

A week has passed since the diplomatic split between Qatar and other major middle eastern countries and uncertainty still lingers in the market regarding Qatar's LNG volumes. Since last week other changes have been afoot. Mauritius, Mauritania and the Maldives have now joined the list of countries severing diplomatic ties with Qatar. The UAE has upped tensions by banning any airline destined to Qatar using its airspace, plus enforcing rules that it will jail anyone who sympathises with Qatar.

Although the LNG shipping market is showing signs of tightening, coincidentally such tightening appears to be fuelled by separate increased activity elsewhere. Such volatility and uncertainty in the Middle East will undoubtedly cause those pending shipping requirements to sit up and watch with ever more vigilant eyes, waiting to move before it's too late. As of now Qatari cargoes are still going into Egypt and nothing as of today has seen this motion change.

Late last week however two Qatari gas ships appear to have diverted their original path through the Suez Canal, to now going the long way around the Cape of Good Hope to get into Europe, fuelling speculation they may have received deterrence from the Egyptian-controlled Suez Canal. But this could also be down to charters wishing to go around the Cape of Good Hope rather than pay the Suez charges. This detour is expected to delay cargoes into Europe by five to ten days. This diversion has caused the European markets to react with front month gas price in the UK jumping the most since January. It is likely though that this sentiment may retain through June but access to cargoes in the long term from y-o-y growth from the upcoming export facilities should see this balance out, and would only affect Europe deeply if the rift continued into deliveries of next year's winter stockpile.

If the trend continues we can expect to see more Qatari volumes entering the Pacific, which should pressure the Asian LNG spot price. The upside/downside to this will be that Japanese utilities in talks with reviewing long term gas contacts will be dealt a stronger hand. Outside of Japan the Qatari diplomatic crisis could now spur both new and existing buyers to seek greater diversification in sourcing amid potential disruption. This could pave the way for new buyers looking towards the spot market to cover volumes. For East of Suez it will be likely that end users would seek more US volumes even though the continent is currently well supplied from Russia.

The other main question that remains unanswered is what effect the LNG shipping market will see on Fujairah prohibiting Qatari ships; Qatari flagged ships; and/or ships coming to or from Qatar from bunkering and anchoring there.

Sources: Bloomberg, Reuters

CRUDE OIL: QATARI FALL-OUT CONTINUES

The markets continue to adapt to the situation in the Middle East, although demand for crude remains firm.

The effects of the diplomatic crisis in the Middle East are still being assessed. Now, with the UAE blocking all vessels which have previously called at Qatar from docking at its own ports, freight rates for those vessels calling at Qatar are now expected to rise, while buyers are splitting cargoes on Suezmaxes, rather than VLCCs, in order to load separately at both Qatar and the UAE.

On Sunday, Qatar moved quickly to prevent tensions from mounting much further; Energy Minister Mohammed al-Sada has reiterated his country's commitment to the global crude oil production cut, which was recently extended to March 2018. The oil markets had been concerned that Saudi Arabia's move to cut diplomatic ties with its fellow Opec member would threaten the deal, but Qatar, which is now producing around 619,000 bpd, has allayed those fears, at least for now. "Circumstances in the region shall not prevent the state of Qatar from honouring its international commitment of cutting its crude oil production," Mr al-Sada said.

Meanwhile, the Energy Ministers of both Saudi Arabia and Russia have given their estimates on global inventories. Russia's Alexander Novak has said that supply continues to exceed demand, despite the decline of stocks worldwide; he is quoted as saying that "to ensure true market balance, it is required that the inventory drops down to the five-year average, and we are sure that it will happen in the next few quarters, probably by the end of the first quarter of next year". Novak also called on a diplomatic resolution to the Qatari crisis, citing concerns over how the situation may affect the current deal and any further cooperation in the future.

Khalid al-Falih, Saudi's Energy Minister, was more bullish; he said that he expects the drawdown of global crude inventories to accelerate over the next three-to-four months.

Demand in the likes of China, India and the US remains high, driving the market to balance. Chinese crude oil imports in May were 8.8 Mn bpd, having risen by 4.7 per cent on the month and 15.4 per cent on the year, according to Platts. Only in March 2017 has it imported more. State-owned refiners accounted for most of the increase. In the US, gasoline consumption also rose in the month of May, averaging 9.6 Mn bpd, a rise of 0.16 Mn bpd on the year. The EIA has just released its latest monthly Short-Term Energy Outlook report, and it has revised up its estimates for gasoline consumption for the year up to 9.34 Mn bpd, a 0.1 per cent increase. Consumption may hit a record-high this summer.

Meanwhile, innovation continues to drive the US shale business. BP has reportedly invest in Beyond Limits, a California-based start-up which is adapting Nasa software for the upstream oil industry. The likes of ENI and Pioneer Natural Resources have, over the past couple of months, bought into new technology to improve the efficiency of shale oil drilling and production.

Sources: EIA, OilPrice, FT, CNBC

CONTAINER: US IMPORTS STILL GROWING

US imports are still rising, but this is set to decline in the months to come.

US import volumes could be about to hit record levels in the coming months, according to US retailers, mainly driven by vigorous consumer demand. However, monthly increases are expected to slow down when compared to what the industry experienced during the last couple of months.

The monthly published Global Port Tracker of the National Retail Federation (NRF) forecasts an August import volume of 1.74 Mn Teu, which would be the highest monthly volume to be recorded since 2000, when the import volumes were first tracked.

But Jon Gold, the vice president for supply chain and customs policy at NRF notices that “year-over-year comparisons are slowing down”, but they “are expecting some of the largest import volumes ever seen, and that’s because retailers are responding to strong consumer demand”.

Throughout the first half of 2017 so far, imports have been growing year-on-year, but at this growth, pace has been slowing down from 16 per cent in March to 11 per cent in April, when it reached 1.61 Mn Teu, before moving to 1.69 Mn Teu in May. All recorded monthly volumes in 2017 so far are larger than the anticipated increase in year-over-year increases to come, with the latest forecasts for August around 1.6 per cent and October further down to 1.3 per cent. The slower year-over-year growth in the next couple of months is related to the timing of this year’s Chinese Lunar Year. Having been earlier than usual, this made shippers rush shipments to the United States in the period before production paused.

The slower industrial output growth at Chinese factories has been another reason behind the declining growth. Industrial production in China expanded by 6.5 per cent in April year-on-year, below the growth by 7.6 per cent in March, with market specialists expecting it to drop further down during the months to come. In the meantime, retail sales managed to maintain their levels but policies coming out of Washington do not allow us to develop strong optimism for dynamic growth.

NRF forecasts that retail sales of the current year, excluding automobiles, gasoline, and restaurants, will expand between 3.7 and 4.2 per cent over 2016, mainly affected by job and income growth coupled with low debt.

In terms of US containerised imports, the growth reached 4.5 per cent in the first quarter, according to IHS, above the earlier prediction of 3.7 per cent, with imports now expected to grow by 6.6 per cent in 2017, close to 22 Mn Teu. The growth in the first half of the year could reach 9.6 Mn Teu, up 6.4 per cent, compared with the first half of 2016.

Northeast Asia and northern Europe have been responsible for the biggest gains, up 12 and 14 per cent respectively year-on-year, while Middle East and Caribbean trades declined marginally, down 4 and 2 per cent year-on-year.

Source: Journal of Commerce

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