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MF Global Daily Report

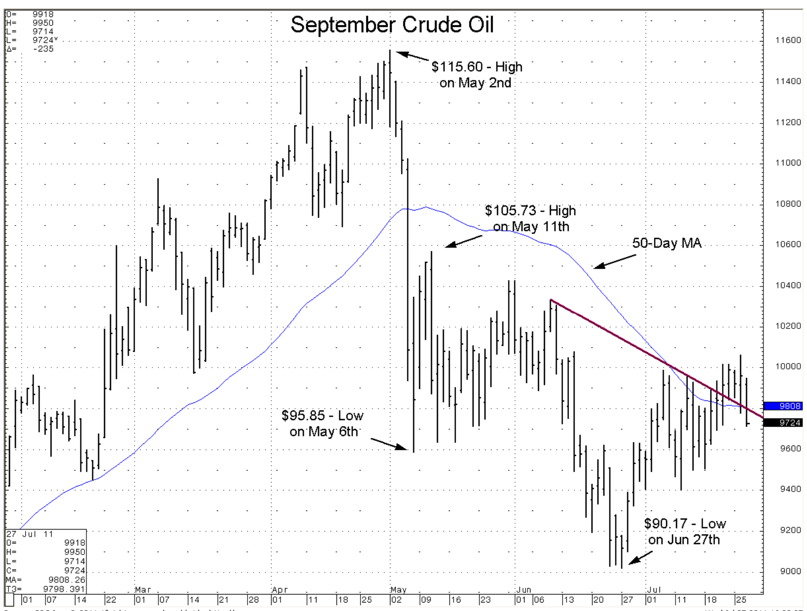
COMMODITIES | ENERGIES

Energy

MF Global
440 S. LaSalle
Chicago, IL 60605

Price Outlook

Oil prices will be a tough call in today's session but seem likely to move lower on balance. Price direction will likely continue to depend on progress made during debt ceiling negotiations. Pressure could come from the continued lack of progress on the ceiling in Washington, concern over European sovereign debt, yesterday's weak EIA report, and technical factors. Opposing support will be offered the likelihood that accommodative monetary policy causes investment to remain in commodities and from the possibility of further pipeline regulations in the wake of Tuesday's small oil spill in Prudhoe Bay by BP. Yesterday's selloff stopped us out of our long recommendation in crude oil at our $98.00/bbl entry point. We favor standing aside or even looking for further weakness in today's session.



Yesterday's trade fell mostly on a lack of progress in debt ceiling negotiations in Washington. House Minority Leader Boehner presented a plan that was intended to cut $1.2T in spending but was scored by the CBO to save only $850B. His package was also being attacked by fellow Republicans as either not cutting enough, or for its super-committee of 12 Congressmen tasked with cutting an additional $1.8T by November. Tax cuts could represent a portion of that additional $1.8T and they would be difficult to stop. For Senator Reid's part, his $2.7T in cuts may actually cut only $2.2T but few Senators have said that they've actually seen the plan. It's based mainly on ending the wars in Iraq & Afghanistan which would have occurred anyway, so it doesn't seem to make many hard choices. There essentially has been no progress made over the last few weeks and markets are reflecting it. Comments from German FinMin Schauble yesterday didn't help either, when he seemed to undercut some of the good news received last week on Greece. He said that the German government is not a blank check for the EFSF to purchase bonds in the secondary market.

Oil prices were pressured yesterday and may continue to be pressured this week by softness in the EIA's inventory report. The report showed a greater-than-expected build in inventories and another decline in the level of demand.

Inventories grew 2.3 MB last week as no refiners chose to process oil released from the SPR. The extra oil went into storage, which weighed on futures contracts out to December and caused the contango to widen. Overall demand fell to 1.18 mb/d below the five-year average compared to 1.02 mb/d below it the week before. The soft patch of May-June was beginning to show signs of recovery in early-July, but the oil data suggest that there is a double-dip soft patch taking place.

TRADE: Long: CLU1 at $98.00, target $102.00, risk $98.00

Upcoming Energy Events

Wed - Oil Inventories 10:30 am EST
Thu - Aug gasoline and heating oil rollover
Thu - Natural Gas Inventories 10:30 am EST
Tue - API Weekly Stats 4:30 pm EST
Aug 9th - EIA Monthly Report
Aug 15th - Sep Brent rollover
Aug 19th - Sep WTI rollover
Aug 30th - Sep gasoline and heating oil rollover

Global Economic & Dollar News

The dollar traded higher throughout the day yesterday, as markets became fearful of European sovereign debt once again. A comment from German FinMin Schauble showed that the government is not a blank check for the EFSF to purchase bonds in the secondary market. The comment seemed to undercut the progress made last week.

» **China Securities Journal** reported that RRR's will not be raised in July or Aug. The PBoC had set a pace of one increase a month this year but reported that the pattern is set to change.
» **China's Financial News** reported that at least one more hike in interest rates may be made by the end of this year and that it will be "small."
» **German FinMin Schauble** said that the German government is not a blank check for the EFSF to purchase bonds in the secondary market.
» **John Boehner's Plan** was scored by the CBO to save only $850B rather than $1.2T sought. Portions of the plan will therefore be rewritten and will be voted on today. There are several conservative House Republicans who will not support this plan because there are not enough spending cuts.
» **Harry Reid's Plan** was scored at $2.2T vs. the $2.7T sought. There apparently are not enough votes in the Senate to pass this plan.
» **The Treasury** will likely have enough cash available to last through Aug 10th due to higher income tax receipts. This was reported by NYT yesterday and by other sources on Monday.
» **The Treasury** later denied the report yesterday afternoon. It said that it can't guarantee when the gov't will no longer be able to pay its bills.
» **WSJ Said CEOs** are communicating through earnings reports that they don't have many intentions to add a lot of new jobs. It said that investments are migrating toward Asia or growth industries.
» **Durable Goods Orders** were -2.1% vs. +0.3% expected and vs. +1.9% previously. Nondefense capital ex-air were -0.4% vs. +0.8% expected and vs. +1.7% previously.
» **The Beige Book** indicated slowing in the economy. It said that the pace of growth continued to moderate in many districts, with fewer districts growing at a steady pace than in the last Beige Book. Wage pressures remained subdued while price pressures moderated somewhat.

Energy News Stories

» **Kyushu Electric** used far more fossil fuels in the Apr-Jun quarter due to worries about nuclear power. It said that it used an additional 1 mln bbls of oil or 8 times more than it planned. If no nuclear reactors are allowed to restart, it can supply 13,530 MW of power in Jan 2012 compared to peak demand of 14,200 MW.

» **Algeria Raised** OSP prices on its Saharan Blend crude to 70 cents over dated BFOE for August compared to plus 40 cents in July.
» **The NYMEX** announced that it would discontinue its heating oil contract from Apr 2013 and expand listings of its ULSD contract to the current year and the next four years. The move follows regulatory changes to reduce the sulfur in heating oil in New York state.
» **The Coal Industry** may have to shut 20% of its coal power capacity, or around 30-50 gigawatts in order to comply with proposed federal environmental regulations, according to consulting firm ICF International.

ANALYSIS

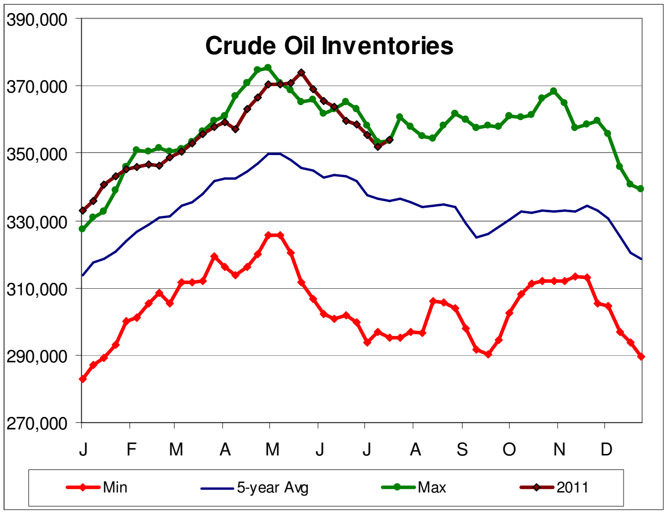
EIA Oil Inventory Review

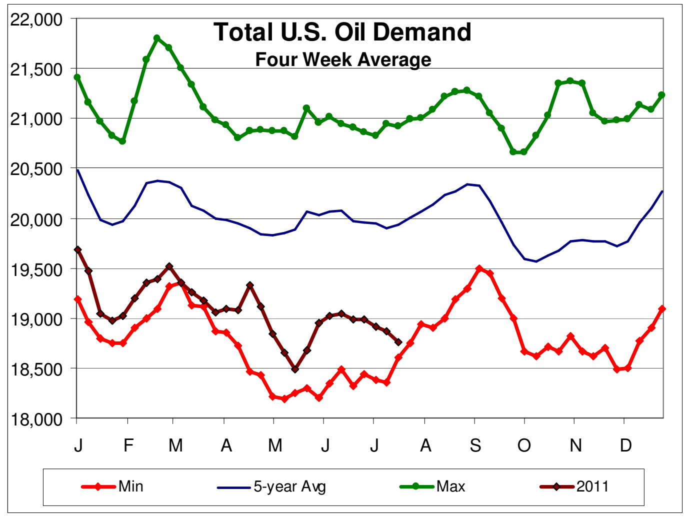
The EIA reported oil stocks yesterday which accelerated an already lower trend in energy prices. Inventories of crude oil actually grew by 2.3 MB during the survey week, which was much above expectations for a draw of 1.7 MB. As-expected, there was some contribution from the release of SPR oil, but disappointingly, another fall in demand helped add to stocks as well. Inventories of crude, gasoline, and distillates grew to 27.64 MB above their collective five-year averages compared to 22.57 MB above it the week before. The data suggest that the SPR release and weakening demand will put energy markets on a path to further easing in the near-term, which should then put pressure on prices going forward. The data and our analysis follow below.

	EIA Inventories - w/e July 22nd						API Inventories		
	Actual	Market Estimate	MFGR Estimate	Five-Year Average	Last Week		Converge with EIA	Actual	Previous
Crude Oil	+2.3 MB	-1.7 MB	-1.0 MB	-0.8 MB	-3.7 MB		+6.5 MB	+4.0 MB	-5.2 MB
Gasoline	+1.0 MB	+0.4 MB	+1.0 MB	+0.5 MB	+0.8 MB		-2.8 MB	-0.6 MB	+2.0 MB
Distillates	+3.4 MB	+1.9 MB	+1.5 MB	+2.0 MB	+3.4 MB		+0.9 MB	+2.9 MB	+1.1 MB
Utilization	88.3%	-0.1%	-0.3%	-0.6%	90.3%		-4.5%	85.8%	86.1%
Natural Gas		+40 bcf	+33 bcf	+49 bcf	+60 bcf				

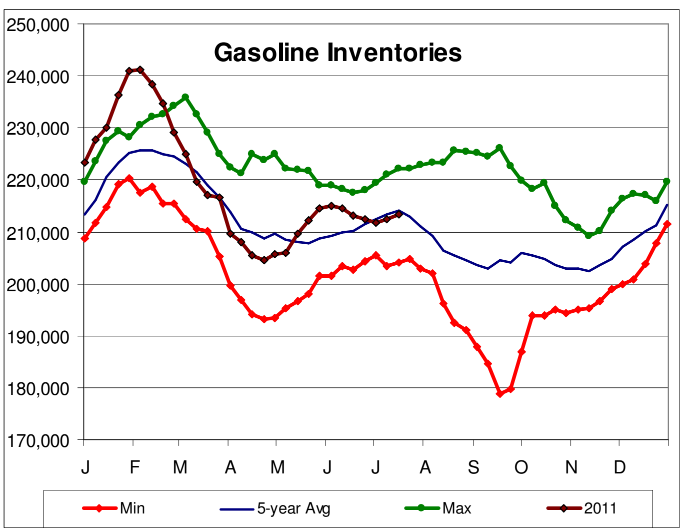
*The API convergence figures are the amounts that EIA data need to change in order to match the previous day's API figures

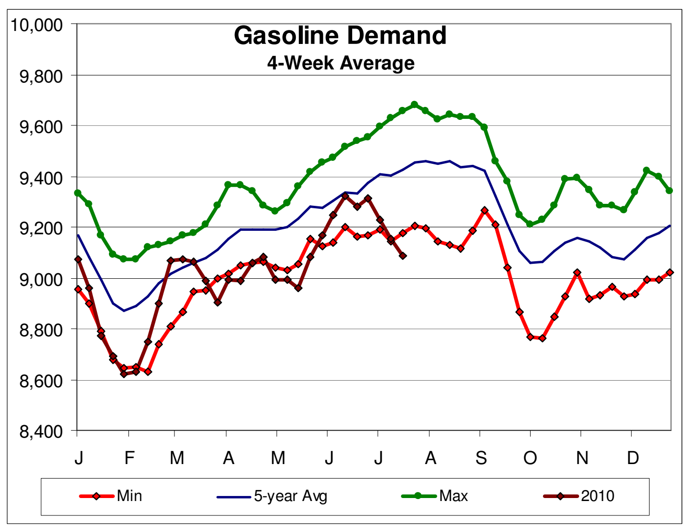
Crude oil inventories grew 2.3 MB in yesterday's report, with a 497 kb/d increase in imports accounting for the bulk of the gain. The rise in imports added about 3.48 MB over the course of the week. A drop in demand of 427 kb/d was disappointing for the pace of the economic recovery and added 2.99 MB over the course of the week. The release of 2.27 MB of oil from the SPR in the Gulf Coast region during the week helped PADD 3 inventories to gain 5.5 MB during the week, which was the largest weekly gain since Jan 21st. Surprisingly, refiners chose not to process any of that oil, with PADD 3 refinery inputs declining by 242 kb/d out of the 353 kb/d lost nationally. We had assumed in our analysis last week that even if refiners were to raise output to their highest levels ever, it would have left an additional 0.4 mb/d of excess oil in PADD 3 that would either have to be shipped to the Atlantic coast or stored. The drop in PADD 3 utilization implies that most if not all of the SPR release went into storage. This point will likely encourage further criticism of the IEA's coordinated release.



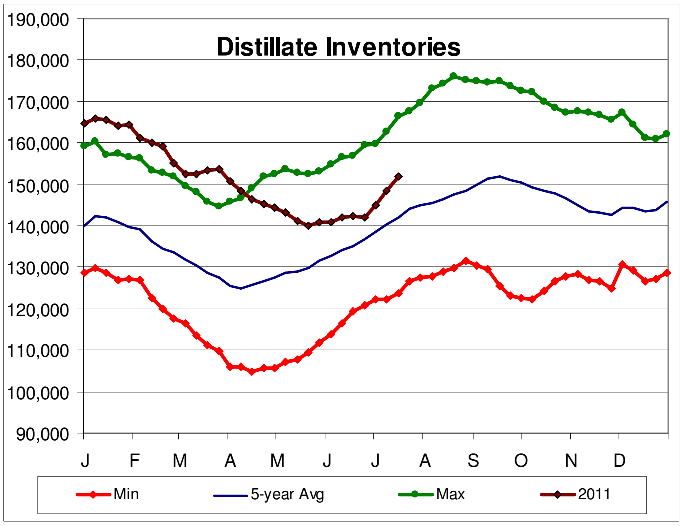


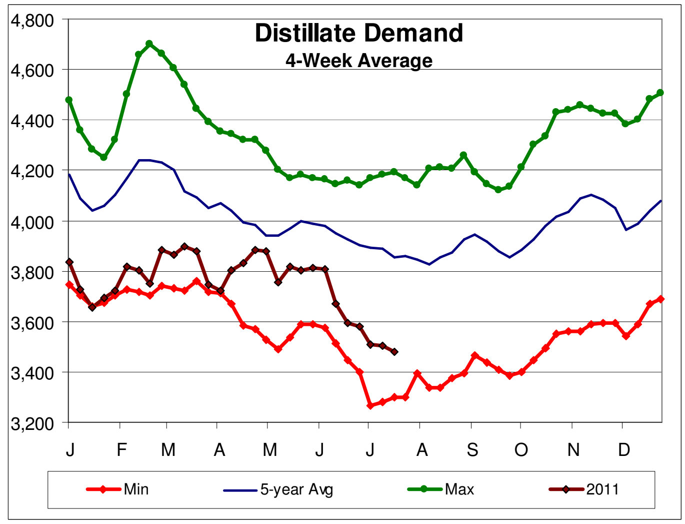
Gasoline stocks gained 1.0 MB compared to a 0.4 MB increase expected. There wasn't much to explain the gain in stocks as imports fell 219 kb/d and refinery production dropped 52 kb/d. Perhaps it was last week's 344 kb/d increase in production that filtered through to this week's inventories. The level of gasoline stocks to its five-year average rose to 0.48 MB below average vs. 1.02 MB below average last week. Gasoline demand fell 29 kb/d and has been sinking fast in the last three weeks.





Distillate stocks rose 3.4 MB compared to a 1.9 MB increase anticipated. Imports increased 69 kb/d and accounted for a portion of the gain. Refinery production actually fell 19 kb/d this week, but last week's 85 kb/d increase may have played a belated role. Distillate demand increased 56 kb/d w/w but large decline in demand in prior weeks helped the four-week average fall another 24 kb/d.


Distillate Inventories
190,000
180,000
170,000
160,000
150,000
140,000
130,000
120,000
110,000
100,000
90,000
J F M A M J J A S O N D
Min
5-year Avg
Max
2011


Distillate Demand
4-Week Average
4,800
4,600
4,400
4,200
4,000
3,800
3,600
3,400
3,200
J F M A M J J A S O N D
Min
5-year Avg
Max
2011