Sharekhan

COMMODITIES Watch

The latest news and views on commodity markets

Gold set to command a good investment demand in 2007

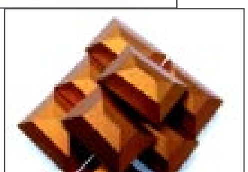
THE HEAT IS ON INDIAN WHEAT

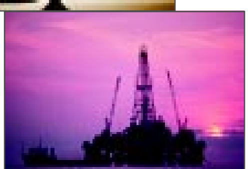
OILSEEDS SLIP IN PRODUCTION IN '07

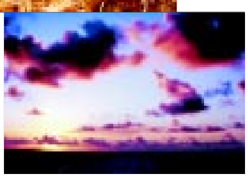
IS CHINA'S GOLD LOSING ITS SHINE?

Contents

Sharekhan Commodities Watch
March 2007





COVER STORY

Gold set to command a good investment demand in 2007

Gold investing has become easy during past two decades. There was a time in India when buying a bar of gold could lead a person to jail. Till less than two decades, the gold imports were banned and almost all the imports were effected by illegal channels. Smugglers flew or sailed from Dubai, Singapore and Hongkong, concealing gold bars in their shoes, belts, and even within their body, to smuggle the yellow metal inside India. Read more on page 14

FOREWORD

Dear readers,

Commodity futures trading is old. Although the first recorded instance of futures trading occurred with rice in 17th century Japan, yet there is some evidence that rice futures were traded in China as early as 6,000 years ago.

India has been a regular commodity market since millennia. People traded in cotton, spices, grains, silks, and countless other things, and exported them to every corner of the globe. Bengal exported indigo, jute, opium, bell-metal, brass utensils, terracotta pots, goods of smithy and carpentry, ivory carving, saltpeter, even cannon balls, and nails. By first century AD Indian textiles had become well known in Rome under brand names like Gangetika and Venti, the latter meaning "woven winds". Pyrard, an early Portuguese explorer, reported that "every one from the Cape of Good Hope to China, man and woman, is clothed from head to foot in the products of Indian looms".

Commodity trading, though severely damaged during the British rule, still continued to be a stronghold of the Indian economy. Premchand Roychand, arguably the biggest cotton trader in the world at that time, operated from across the country. His trade executives were stationed in London, Tokyo and New York, and he acted as a price maker in global markets.

I am talking of those earliest times because today India stands at the crossroads of commodities trading. Bolstered by its past expertise in commodities trading the young nation is all set to blaze a new trail in the field of commodity futures trading.

Though computer based trading of commodities is barely three years old in India, within this small period of time it has secured a very important place in the financial world. Newspapers are trying to increase their content on commodities, investment banks are hiring top notch commodity traders at fees that draw jaw-dropping reactions from film stars.

Even students have been bitten by the commodity bug; more and more of them are enrolling in commodity courses, as a result of which the colleges are clamouring to begin commodity courses. So much so that the reputed management colleges are making sure they have at least a couple of sessions on commodities.

And last but not the least, investors are catching a fancy to commodities. Lay investors are increasingly asking for information on these new tradeable things and some of them even want to have some exposure to commodities.

This is where we come in the picture. At Sharekhan we have always tried to provide a secure platform to our investors, be it equities or mutual funds or any other mode of investment. Moreover, we have striven to see that investors make their investments not on "market gossip" or "gut feeling" but based on proper information. We feel any investment that is not based on comprehensive research is doomed to fail, thereby leading to heavy losses, both mental and monetary.

The launch of ***Sharekhan Commodities Watch*** is just a step in that direction. The magazine, which is the result of efforts of Sharekhan Commodity Research Bureau, is aimed at informing the investors of the widest possible range of information on commodities. It will cover every major news that percolates to the commodity markets, in a way to help investors make better investment decisions.

I hope investors will find that the time spent in reading ***Sharekhan Commodities Watch*** has been a good investment.

Happy investing.

Tarun Shah.

Tarun Shah
CEO
Sharekhan Limited

FROM EDITOR'S DESK

Commodities will continue to be the darling of investors in 2007

Commodities are increasingly becoming an integral part of Investment World. Gone are the days when financial world looked at grains and spices and metals with contempt and limited their activity to dealing in paper based investment vehicles alone. Today the major investment banks and broking houses have special commodity desks as a rule; in fact commodity dealers and fund managers are being wooed with dream salaries.

Reasons enough why Sharekhan Limited had decided to dedicate a separate investment magazine to commodities and commodity investments. Commodities are a vast arena and pretty much a new ball of game for investors in India. This issue as well as the coming issues of ***Sharekhan Commodities Watch*** will strive – among other things – to spread awareness about commodities and help investors make more knowledgeable decisions while investing.

The magazine will be published on a monthly basis however, with the passage of time, it may be converted into a fortnightly publication. As can be understood, you the reader are going to play a vital role in the development of the magazine. All the feedback and criticism is welcome. We will do our best to meet your expectations in the coming issues, to the best of our capabilities.

Coming back to the subject of commodities becoming increasingly the integral part of the investment world, let me pull your attention to one or two significant news on this front. According to a report based on investor survey by Barclays Capital released recently, the investor interest is intensifying toward commodities in order to broaden their portfolios. The report - which is based on surveys of participants like large pension funds, retail distributor, and hedge funds - claims that investors are increasingly trying commodities as methods available to gain exposure to the market get more creative. Some investors are clearly making very carefully studied decisions to make sure that they have some commodities in their basket of investments.

While about 50 percent of survey respondents in Europe said their portfolios contained no commodities exposure in 2004 and 2005, 93 per cent respondents emphasized that their portfolio will surely contain some commodities during the next three years.

New York respondents indicated a significant shift into commodities, with more than 50 percent saying they'd seek to make commodities more than a tenth of their total portfolio.

The proportion of Barclays Capital's clients expecting to invest more than 10% of their portfolio in commodities over the next three years has more than tripled in the past year to 53%, according to the study, which polled pension funds, hedge funds and retail distributors, among others.

To add to the bullish scenario, the clients look set for a long innings. More than half the respondents expect to be invested in hedge funds in the next three years, up from 21% in a similar survey a year ago, while those looking to invest in index funds have slumped to just 3% from 47% a year ago.

The increased participation is likely to come from other quarters as well. Recently there has been the news of CalPERS, the largest public pension fund in the United States, planning to create a new natural resources/commodities asset class within the pension fund. Global demand for natural resources and proved systems to extract and deliver them will only increase," said Valdes. They are bullish because the global demand for natural resources is bound to increase with time.

> The surge in commodity investing has been amply aided by gains in prices of virtually all the commodities. Commodities offered some of the most unimaginable returns during 2005. Natural gas went up by 93.87%, Sugar: 60.09%, Heating oil: 44.94%, Crude oil: 44.92%, Silver: 40.89%, Copper: 37.90%, Soybean meal: 21.70%, Cotton: 21.04%, Gold: 20.85%, Soybeans: 14.57%.
>
> Simultaneously, the Bank of Nova Scotia commodity price index enjoyed a gain of over 26 per cent in 2005, its biggest jump since 1979 and third biggest since the Arab oil embargo drove it up almost 43 per cent in 1973.

They want to look into commodities future contracts and related investments to complement, diversify and add value to their expanding securities investments in the energy and raw materials sector.

CalPERS currently invests 8.4% of its assets in the natural resources sector, focusing mainly in energy and raw materials production and distribution.

Even though some commodities have experienced a pull-back in prices during May 11, 2006 meltdown, the returns they provided during 2006 have still been phenomenal.

There is yet another reason for the popularity of commodity investments: lesser initial cost. Commodities, like stocks, can be bought on margin. However, unlike stocks, - where an investor has to put up at least 50 percent of the price of the shares - the margins on commodities are often as low as 5 percent. This means that while you need to pay $50 for every stock purchase worth $100, you may buy $100 worth of gold by paying as little as $7.

In the past the investors were not so conversant with the commodities and commodity futures, and the general perception was one that of fear rather than that of making money. However during last two-three years lot of water has flown and investors have come to understand the markets better. They realise that while speculation in commodities is possible, the speculators can only have a short-term effect on the prices. If speculators manage to drive up the price of oil artificially, oil producers with excess supplies will gleefully dump their oil on the market driving the price back down. The realisation that the market is bigger than the speculators is pulling investors to commodities.

Not surprisingly, there is lot of activity on the M&A front. Commodity bourses, both local and global, are going through lot of upheaval. Around the world the mergers and acquisitions are being announced at a speed not witnessed during the 150 year history of commodity exchanges. Takeovers and mergers are being organised to develop joint projects and share information on, for example, financial and derivatives market.

The undercurrent is hitting Indian shores as well. Recently there was a report that New York Mercantile Exchange (Nymex) has initiated discussions to acquire a 9% equity stake in the Multi Commodity Exchange of India (MCX).

MCX is India's largest commodity exchange founded by Financial Technologies India. While FTIL holds 64% stake in MCX, the rest is held by various state-owned and private sector banks. Though just three years old, MCX is the second largest commex in the world in terms of the number of silver contracts traded and third largest in terms of the number of gold contracts traded.

While the rumour of Nymex purchase are yet to be confirmed officially, other exchanges around the world are surely on the M&A track. According to a report in Reuters, so far this year, at least 24 mergers worth about $25 billion have been announced between securities exchanges. "Among the biggest was New York Stock Exchange operator NYSE Group's proposed purchase of Euronext, the operator of the Paris, Brussels, Amsterdam and Lisbon bourses, as well as London's Euronext.Liffe derivatives exchange."

Commodity exchanges of late have become the toast of the investment circles. High trading volumes boosted by hedge funds and a boom in commodities trading coupled with the across the board rise in price of commodities have helped drive the interest in financial exchanges.

Indian commodity exchanges are attracting a lot of attention globally. The first reason is that Indian exchanges are nascent; with commodity trading having begun just three years back, the exchange owners have not fully realised the true potential of their possessions. Naturally, the globally established exchanges are out to help themselves with some easy pickings.

More on this in the subsequent issues.

Till then, happy investing in commodities.

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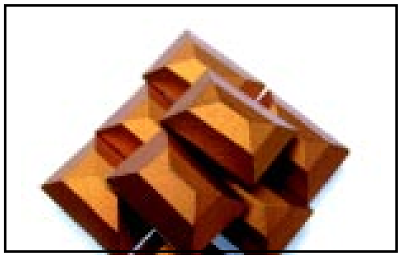


BULLION WATCH

China's gold consumption stays flat in 2006

China consumed about 240 tonnes of gold in 2006, roughly unchanged from the year before, as increased wealth offset higher prices that had caused buying in most countries to drop, the World Gold Council's Far East MD said on 30 January.

Gold buying in China rebounded in the fourth quarter, he said, after a 25-year peak price of $725 an ounce depressed buying by 2% in the second quarter from the year before.

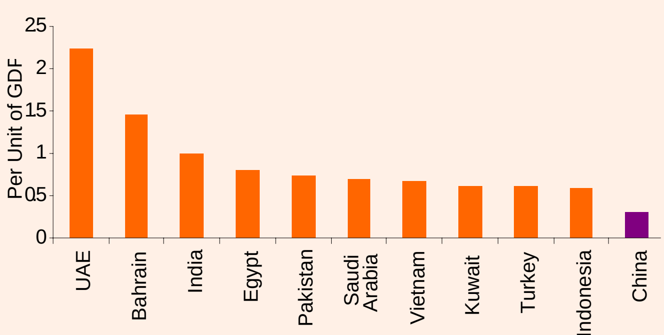
"The fourth quarter was much better. It was very, very good, actually," Albert Cheng, the council's Far East MD, said. China's economy grew by 10.7% in 2006, helping gold demand stay stable despite the high prices. In 2005, China's gold consumption rose 7.7% to 241.4 tonnes, according to council figures.

Although the consumption during 2006 has not gone up, the same is expected to go up during the current year. According to the trade pundits, the Year of the Pig may well turn out to be the Year of Chinese Gold Buying Mania. During November the China Gold Coin Corporation announced that it was to issue a series of gold bars stamped with the image of pig, the symbol of year to come. The year of the pig happens to be the last and luckiest year of the 12-year rotation of the Chinese lunar calendar.

What is likely to add fuel to the fire is that the Year of the Pig also happens to be the Year of Metal, which is anticipated to make people gobble up those golden pig bars in weights of 1000g, 500g, 200g, 100g and 50g.

Emotional buying apart, the fact remains that gold buying is increasingly becoming popular in China. The retail sales figures have been going up consistently. In 2003 and 2004, China's retail sales of gold and jewelry ornaments increased by 11.7 percent and 27.5 percent respectively. Simultaneously, the country's diamond imports reached 900 million dollars in the period, up 17.5 percent, and as can be understood, most of these diamonds are wrapped in gold jewellery.

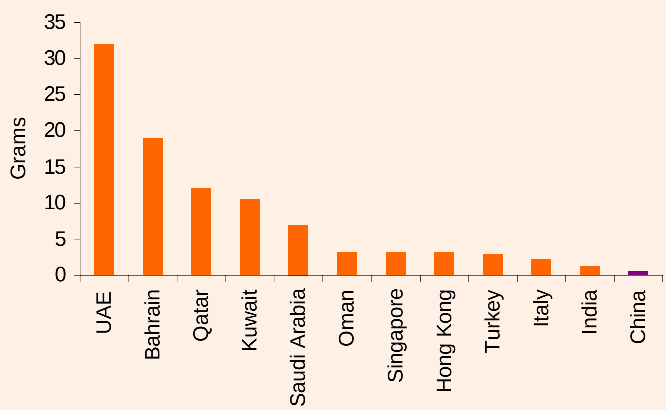
Jewellery offtake



China is predicted to consume a record 350 tonnes of gold this year, up 17% from 2005, against 240 tonnes of local production. During last couple of years the country has emerged as the world's third-largest gold consumer, 80% of which is used for jewelry.

In part this gold buying frenzy is due to the new prosperity, and in part it is due to the government liberalizing the gold ownership policies. In October of 2002, China authorized private ownership of gold for the first time in 50 years. This is yet another proof of the government's vision to build capital assets instead of spending the money on shallow pleasures.

Per capita jewellery demand



The Chinese leadership has always placed great emphasis on the distant future, and has openly persuaded its citizen to endure short-term pain in the interests of achieving long-term goals. People have surely taken the advice, for in the first half of 2005, the retail sales volume of 1,000 of China's major gold, silver and jewelry companies increased by 13.9 percent.

Towards this end, the government is doing the maximum it can do. For starters it is making gold purchasing easier than ever before. Take for example the recent announcement by the Shanghai Gold Exchange to offer individual investors gold in lots of 100 grams, a tenth of the size of the existing product, in a bid to raise trading volume.

Gold (30 days)

Individual investors can buy or sell the new product, known as Au100g, through the 16 so-called financial members of the exchange, which happens to be China's biggest precious-metals market. They can also buy gold from other members approved by the People's Bank of China, according to an exchange statement.

The previous qualifying level of gold investment was set at a minimum of Yuan 160,000 or about US$ 20,400 at current exchange rate, a level that virtually barred most potential Investors. With the new threshold being set at a much lower price of Yuan 16,000, more individual investors would be able to buy gold bullion.

According to some observers, the Chinese citizen's demand for gold may lead to higher gold prices in years to come. Even if just one per cent of the Chinese population of 1.3 billion people were to buy just one ounce of gold each, it would mop up 13 million ounces or about 404 tonnes of gold from the gold market. Such a demand is likely to be bullish, especially since the world is already having a demand/ mining supply deficit of around 1500 tonnes per year.

Sharekhan Commodity Research view: **Bullish**

Will China increase its gold reserves in 2007?

Not just people even the Chinese government is likely to emerge as a big buyer in years to come. There is a logical case for China to increase its reserves. If the Communist country was simply to follow the model of the Western countries, it would need to be in the gold market for long. As of now the European and American countries are the largest hoarders of the Midas metal.

The US has 74.5% of its foreign exchange reserves in gold, with Germany, France, and Italy all above 60% as well. Even Spain at 48.9% and Austria at 43.3% have far higher gold-denominated reserves compared to China which has no more than about 1.3% gold reserves. (In fact of the top five holders of reserves globally, each of who holds over $200 billion in reserves, all have less than 5% of reserves in gold. For example JapanÆs $880 billion reserves are gold-denominated to the tune of 1.8%, making Japan yet another country likely to play a bullish fiddle for the gold market in years to come.)

John Ing in his paper "Gold - The Implications of a China-centric World" expects that China may increase its "gold reserves to at least 10 per cent of total state reserves from the current 2 percent holding." According to him, China has increased its gold reserves by a third in recent years to 600 tonnes, worth about $12.4 billion. "With China's economy growing and with the entry into the WTO and other global institutions, China would like to have sufficient reserves comparable to the western economies."

SHORT TAKES

Coffee futures trading begins on MCX

The Multi Commodity Exchange (MCX) has commenced futures trading in Robusta coffee on Monday, 29th January. It is expected that coffee futures introduced by MCX will not only provide a mechanism for price discovery in a transparent way but will also aid coffee growers in making decisions about selling their produce.

Although coffee accounts for only 3.1% of total agricultural exports, it is one of the most important agricultural exports of the country. It also happens to be a very important commodity on international bourses.

MCX has linked the trade with that in Euronext-Liffe. The trading unit is one tonne and delivery unit is three tonnes (50 bags of net weight 60 kg each). The delivery centres identified are Kushalnagar, Chikmagalur and Hassan in Karnataka and Kalpetta in Kerala.

The MCX coffee contracts also provide flexibility in that they can be traded late in the evening, till 11-30 pm IST, when Euronext-Liffe trading is on. This would enable traders to cover their price risk exposure while the global trading is taking place.

India, world's sixth largest producer, produces 274,000 metric tonnes of coffee annually which constitutes of 94,000 tonnes and 180,000 tonnes of Arabica and Robusta coffee respectively. More than 70% of Indian coffee is exported. Coffee is grown mainly in Karnataka, Tamil Nadu and Kerala. Chikmaglur, Hassan and Wayanad are the major growing regions.

As per the contract specifications, basis variety will be Robusta and Basis price will be calculated by taking Euronext-Liffe Robusta coffee price, multiplied by Indian rupee:dollar rate as declared by RBI.

The basis price would link to Euronext-Liffe, giving the traders the advantage of settling at the base price. Initially, MCX Robusta coffee futures contracts will be available for the months of March, May & July 2007, all of them bi-monthly.

Investment Olympics 2007: Silver may beat Gold

This is what silver has been doing recently; it has been beating gold in the investment arena, consistently. During 2006 while gold appreciated by 23%, silver went up by 45.5%. The previous few years saw the same phenomenon; 2005 saw gold appreciating by 20% and silver by 38%, 2004 (gold up by 4.8%, silver up by 13.2%0 and 2003 (gold up 22%, silver up 28%).

So does it take rocket science to predict that silver will again outdo gold during the coming year? Not really. Silver is both an industrial commodity as well as an instrument of wealth, cheaper and more liquid alternative to gold. History has favoured silver as a store of value since the beginning of time. However today the industrial demand primarily underwrites the price.

> Only 30 percent of the newly-mined silver available to the market in this 21st Century comes from primary silver mines. This means that a 10 percent increase in silver output from new or existing primary silver mines only adds 3 percent to the total supply. Only large-scale new mine projects in lead, zinc, copper and gold will change the supply equation, and these are not driven by the silver price.

Every time we switch on a microwave oven, a dishwasher, clothes washer or TV set, we employ some use of silver. Silver is used in circuit boards and is essential to electronics to control the operation of aircraft, car engines, electrical appliances, security systems, tele-communication networks, mobile telephones and TV receivers. A great majority of computers use silver-membrane switches. They are used for cable television, telephones, microwave ovens, learning toys and keyboards of typewriters and computers.

> Oil is different from silver. As oil prices rise, people begin to think about alternatives such as nuclear, wind, solar, or newer technologies, or conservation. And there has never been a mass movement by the public to go out to buy $7,000 worth of oil, in 100 barrels, to store on the front lawn.

With uses as diverse and as commonplace as these, the demand is inelastic. Most of these applications employ very small quantities of silver that a rise in the silver price will have little effect on demand. A washing machine uses about 15-20 silver-coated switches, which means a company would save next to nothing if the price of silver was to go up twice or thrice the prevailing levels.

To add fuel to the fire, the metal is in perennial supply deficit. In 2005, mines supplied 641.6 million ounces of silver to the market while the world consumed 911.9 million ounces. The difference was made up by dwindling government stockpiles and recycling from photography.

In past decades, the shortfall between newly-mined silver and industrial consumption, approximately 200 million ounces/year, was met by sales from government stockpiles. The United States in 1959 held more than 2 billion ounces in its treasuries. This silver had been accumulated during the Great Depression and World War II, and produced from U.S. mines under government edict at a set price. Today no government of private party has such an stockpile, indeed will never ever have, unless some alchemist cracks some Sumerian code.

The demand/supply balance is so tight that even the U.S. government is a net buyer to fund its mints. And it is paying ten times more the price at which it sold its billions of ounces during the sixties.

> GFMS expects significant price volatility, but, over the next few months at the least, a bias to the upside, with a spike to $15 very possible.

The very exit of the US government from the silver market is a clear catalyst. Other governments like India and China are known to be selling silver during past couple of years, but a look at the market dynamix tells us that these sales are having no or little impact on the prices.

Considering these facts, it won't be difficult for silver to beat gold in 2007 yet again.

Sharekhan Commodity Research view: **Bullish**

Quotable Quotes

- "Gold was not selected arbitrarily by governments to be the monetary standard. Gold had developed for many centuries on the free market as the best money; as the commodity providing the most stable and desirable monetary medium."

  Murray N. Rothbard

- "No other commodity enjoys as much universal acceptability and marketability as gold."

  Hans F. Sennholz

- "Knowledge is not simply another commodity. On the contrary. Knowledge is never used up. It increases by diffusion and grows by dispersion."

  Daniel J. Boorstin (American social historian and educator, 1914)

METAL WATCH

Tin coming out of can

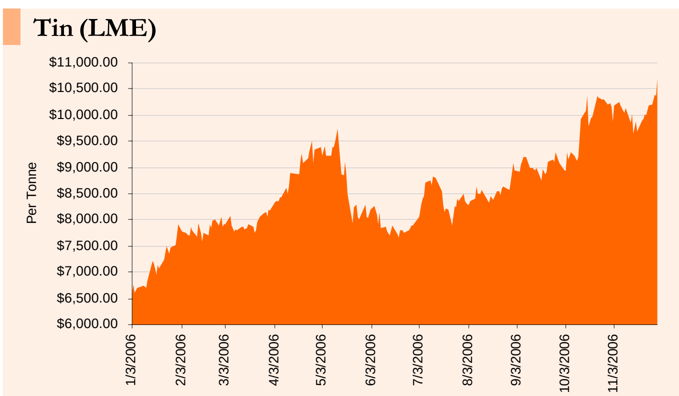
It is said every dog has his day. Tin, the metal whose prices were languishing till recently, and which was hardly being talked about in the media, is finally getting what it has been deserving. The malleable, ductile, highly crystalline, silvery-white metal is currently trading at a 17-year high on the London Metal Exchange.

On 21st February, 2007 spot tin at LME was trading at US$13,845 a tonne – the highest level since 1989.

And it is being said that this is just the beginning. With demand expected to increase and supplies being curtailed, many metals analysts reckon there will be further rise ahead in the short to medium term.

So what's behind the price rise? First, there are fears on the supply side. The current market shortfall in tin production over rising consumption is put at some 25,000 tonnes for next year.

About 35 countries mine tin throughout the world. Nearly every continent has an important tin-mining country. Tin is produced by reducing the ore with coal in a reverberatory furnace. This metal is a relatively scarce element with an abundance in the Earth's crust of about 2 ppm, compared with 94 ppm for zinc, 63 ppm for copper, and 12 ppm for lead. Most of the world's tin is produced from placer deposits; at least one-half comes from Southeast Asia.



The immediate price surge has been due, though, to the Indonesian crackdown on around 20 small independent tin smelters which are operating illegally and whose output is reported to be of unreliable quality. The predicted shortfall for 2007 amounts to around the volume that has been produced by the small Indonesian smelters in the past.

On the demand side there has been a substantial growth. The demand increase has been fueled by growing use of lead-free solder, which is 96% tin, mandated by EU regulations that became effective in mid-2006.

Yet another reason for increased demand, according to some observers, is that the people around the world are using more packaged food. Tin-plated steel containers are widely used for food preservation, and this forms a large part of the market for metallic tin.

And now the important question? What the new year heralds for this industrial metal? Bullish undertone seems to be written all over. The observers are placing tin alongside zinc and nickel as base metals where demand is expected to exceed supply over the next few months at least.

The demand seems to be good, specially with increase in electronics manufacture, particularly in China. Tin consumption is likely to rise further as solder manufacturers are under pressure to eliminate lead on environmental and health grounds.

According to a recent study by Societe Generale, a leading european bank, a world tin supply deficit of 10,000 mt in 2007 is forecasted. This is more than three times the deficit compared with an estimated 3,000 mt deficit in the year just over.

Although SG thinks tin output could climb 3% in 2007, not even this increase is likely to cap the price. According to Societe Generale's estimates a slightly higher average price of $8,750 can be expected in 2007.

Sharekhan Commodity Research view: **Bullish**

Barclays bearish on zinc and copper, bullish on nickel

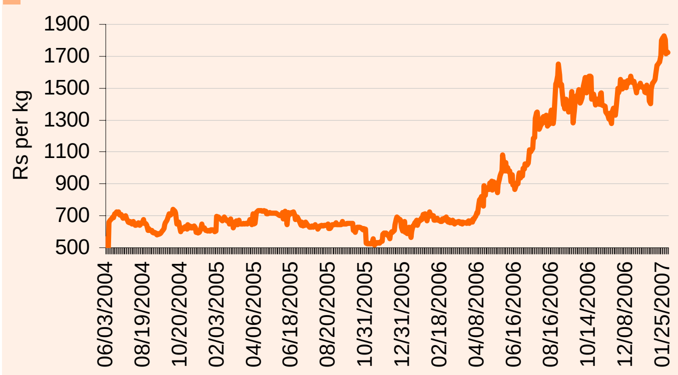
Barclays Capital, the investment bank of Britain's third-largest lender, has cut 2007 copper and zinc price forecasts and raised nickel and tin estimates.

According to the Bank's latest report, copper for immediate delivery will average $6,025 per tonne this year. Zinc is forecast to $3,700 a ton, remarkably down from $4,200.

Recent big increases in London Metal Exchange copper inventories have helped the already negative sentiment. Copper stockpiles in warehouses monitored by the LME have gained 15% this year, accompanied by a 11% slump in the benchmark three-month LME copper price during the same period.

Another reason is the expectation that the housing bubble in the US is set to burst. A slowing U.S. housing market is likely to dampen copper prices in the near future. Home construction fell last quarter at the fastest rate since 1991. Builders are the biggest buyers of copper, which is used in wires and pipes.

Nickel price on MCX



And last but not the least, speculation is rife among buyers and investors that the world financial picture is no longer rosy. Copper is considered a metal closely connected with the global economy and industrialization. The general prediction has been for a slowing in the world's economic performance from its currently quite remarkable 4.8% to a marginally more reasonable 4.3%, which still suggests substantially increased take-up of the metal in 2007.

China, which has been the driving force for much of the base metals demand, particularly for copper, has been destocking throughout 2006. However now that the prices have dropped considerably, inventories are likely to be re-assessed and rebuilt, which will mean apparent demand around the year end may be a degree higher than generally predicted. Shanghai monitored copper stocks did, in fact, rise this week, but are still around 23,000 tonnes down over the past ten months.

However Barclays is bullish on nickel. According to the report, the average nickel price this year is likely to be $32,750 a tonne, compared with a previous forecast of $31,294. Growing usage and supply disruptions have helped prices more than double in the past year.

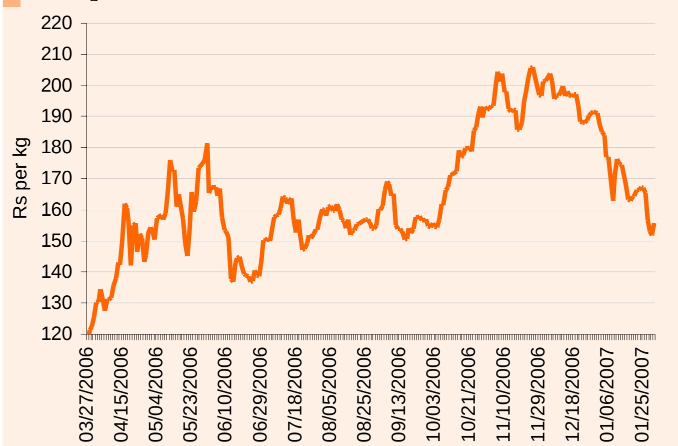
Barclays has reasons to be bullish. Around 65 percent of all nickel is used in stainless steel and a further 20 percent goes into other steel and non-ferrous alloys, most often used in highly specialized industrial, aerospace and military applications.

Such diverse and compelling uses dictate a non-ending demand for the metal. Not surprising the inventories on LME have fallen by more than 30 percent to 3930 tonnes (as on 21Feb), the stocks barely sufficient for less than one day of global consumption.

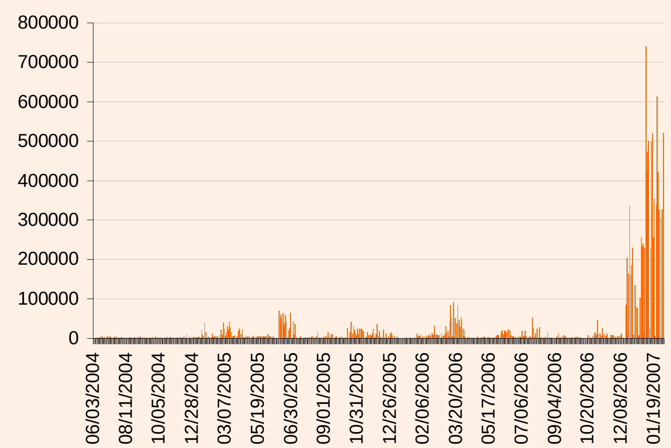
At the same time the supply side constraints are growing, thus providing one of the reasons for price jump. Many mines are seeing strikes by the workers, most notably in New Caledonia. According to the experts the supply disruptions at Inco's New Caledonia mine and a strike at Eramet to some extent explains the recent spike in price which is up by 16 percent in just over a week.

Another reason is that the new mining capacity takes time to come on stream. There are scores of projects being put in process, but it will take years for them to come roaring down the markets. Some experts feel that even if all the currently committed projects were to move

Zinc price



Nickel volumes on MCX

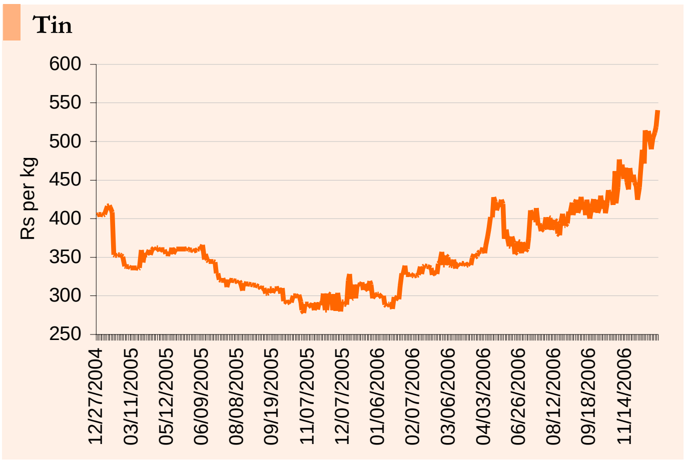


ahead as planned, the increase in nickel supply would exceed the increase in nickel demand by some 16,000 tonnes - but only in 2011.

Concerns about ecology are also causing further delays. Many countries are coming out with newer set of guidelines aimed at making mining much more eco-friendly. Owe it to this fact, a court in France recently ordered a CVRD-associate company in New Caledonia to halt the construction of part of its nickel plant for environmental reasons.

So what lies ahead? The experts predict demand for nickel to increase steadily till 2010 at least. Stainless steel production - the biggest use for nickel - is expected to grow at around 5% a year. Some industry watchers expect that high nickel prices will force some Chromium/ Nickel stainless steel alloys, the largest sector of the market, to be replaced by Chromium/Manganese alloys or plain Chromium alloys, and thus cool down the demand for nickel, and hence its prices. However others feel it was a case of wishful thinking; even if this was to happen, they claim, the overall nickel demand is anticipated to continue growing at over 4% pa.

Meanwhile China, which overtook Japan as the world's biggest stainless-steel producer last year, is consuming more nickel. The combined supply shortfall last year and in 2007 will be 57,000 tonne, BHP Billiton, the world's largest miner, said in December.



Sharekhan Commodity Research view:
Bullish on Tin. **Bearish** on Zinc.
Nickel, Copper.: **Neutral** to Bearish.

COMMODITY QUIZ

Here is a quiz which will tell you how well have you been reading *Sharekhan Commodities Watch*:

- 2007 is being celebrated in China as The Year of the ....." which also happens to be the "Year of .....".
- During 2005 and 2006 the consumption of gold in China has been in the range of .... tonnes.
- Even if just one per cent of the Chinese population of 1.3 billion people were to buy just one ounce of gold each, it would mop up about ....tonnes of gold from the global markets.
- Barclays Capital has cut 2007 copper and zinc price forecasts and raised .... and .... estimates.
- A slowing U.S. housing market is likely to dampen ..... prices in the near future.
- Around 65 percent of all nickel is used in the production of ..
- China, which overtook Japan as the world's biggest stainless-steel producer last year, is consuming more .... of late.
- MCX has linked the coffee futures trade with that in .... The trading unit is one tonne and delivery unit is three tonnes.
- India produces almost 10 per cent of world oilseed output, in the process qualifying as world's ..... th largest edible oil economy.
- Tin is facing extra demand because of growing use of .... solder, which is 96% tin
- Which metal has gone up from less than 3 dollars a pound in 2002 to more than $18 today?
- Which hedge fund posted strong gains in 2006 but suffered almost 20 percent loss in the first days of January and is now trying to stall investors who want to pull money out?
- In which country Phelps Dodge Corp. has recently received a conditional approval from its board of directors to develop the initial mining project?

Each of these questions have their answers hidden in the reports contained in the present issue. Kindly go through the stories again to locate the answers.

Diminishing Chinese copper imports

Barring last couple of days, bearish news has continued to hog copper throughout 2007. The last major salvo was fired by the report of heavy losses Red Kite, a hedge fund endlessly bullish on the red metal. This was follwed by a Bloomberg report that claimed that copper imports in China were down almost 36% during 2006 on a year to year basis. Other reports mentioned continued absence of Chinese buyers, was primarily the reason for price crash during early February.

Copper MCX

Although since then the price has stabilized, the traders' aversion is yet to fade out. Even as the "metal with the Phd in economy" is back more or less to the the start of the year, many industry watchers continue to hold bearish cards close to their chests.

Their reasons: first many people harbour the idea that the Chinese imports may go down further during the year to come. Recently a report by the People's Bank of China said that the Asian nation's economy may expand 9.8 percent next year, slower than a previous forecast of 10 percent. It is expected that a slower rate of growth may reduce the demand for the industrial metal.

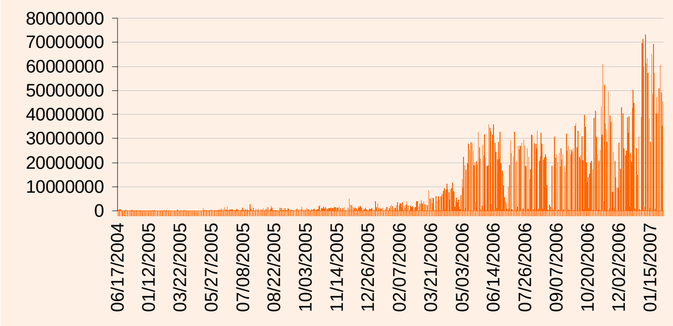
Second: the news from supply side has been somewhat dampening. With the news that workers belonging to two unions at the world's largest copper mine had ratified a proposal from Chile's state copper company Codelco, the prices have been expected to take a beating.

Many people continue to be bearish because of news of more supply seemed set to come on stream. A couple of weeks back Phelps Dodge Corp. had announced that its board of directors had given conditional approval to develop the initial mining project at the Tenke Fungurume copper/cobalt concession in the Democratic Republic of the Congo. Although the final seal of approval is yet to be fixed on the agreement, it is being expected that more metal may come into the markets.

As and when this happens, it will initiate exploitation of one of the world's largest high grade copper deposits. The initial project will focus on 103 million metric tons of oxide ore reserves. Phelps Dodge expects it to be in full production in late 2008 or early 2009. During the first 10 years of mining, total annual production is projected to be approximately 250 million pounds of copper and 18 million pounds of cobalt. The life of the initial project is anticipated to be approximately 40 years.

Supplies seem to be increasing elsewhere as well. Mines in Peru and Mexico are also set to see significant copper output during the coming year. In an interview with Reuters recently, the world's third largest copper miner, Grupo Mexico, said it expects to significantly raise its

Copper volumes on MCX



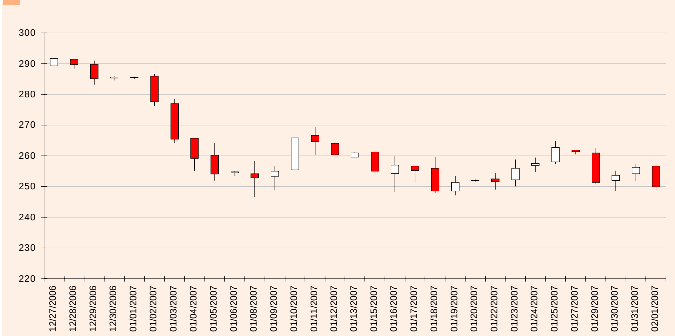
copper output in 2007 as expansions at Peru's major Toquepala and Cuajone mining operations come on line.

The company's Southern Copper subsidiary has resumed nearly 95% of its normal production at the La Caridad mine, while its other large Mexican copper mine Cananea is now beating processing records after strikes ended in July, according to Juan Rebolledo Grupo Mexico director of international relations. However, the strikes resulted in a 16% decline in copper production or a loss of 57,000 tonnes for a total output of only 426,000 tonnes for the first nine months of this year.

More supply is expected from BHP belt in Chile. The unionized workers at BHP Billiton Ltd.'s (BHP) Cerro Colorado copper mine in Chile received a sweetened contract offer from the company Sunday, and voted to accept it, calling off a strike planned for Feb. 7, a union leader said on 4th February.

So what's the future? Some experts are expecting copper to trade down to around $2.50 a pound by the middle of the current year. Others are more bearish, and expect copper to be below $2.00 by the end of 2007. Recently Merrill Lynch predicted a 30% fall in price next year. According to the report copper will fall to $2.40 a pound next year and $1.65 in 2008. And of course, there are analysts who are predicting long-term copper price to hit a low of $1.35-$1.50 a pound. However in the short term the red metal is expected to keep the investors surprised if not shocked. With the Chinese buyers set to make a reasonable comeback, it should not be shocking if the metal goes for one of two smart spikes.

Copper during 2007



Sharekhan Commodity Research view: Neutral

Nickel in good nick?

There are few things that multiply in price 10 times in 3-4 years' time. One such commodity is nickel. What used to sell in 2002 for less than three dollars a pound is today costs almost $20. The price, as can be seen from the accompanying graph, has been rising steadily during last 4 years. The metal surged to a fresh record peak in London on during the last week of February and at the last call (26 Feb) one pound of silvery white metal that takes on a high polish was costing $19.91.

According to a report on Bloomberg, "Metal's prices are so high that the U.S. Mint last year banned exports of nickels to prevent scrap merchants from melting down coins in developing countries. The 5-cents coin, which is 25 percent nickel and 75 percent copper, contains metal currently valued at 7 cents."

Around 65 percent of all nickel is used in stainless steel and a further 20 percent goes into other steel and non-ferrous alloys, most often used in highly specialized industrial, aerospace and military applications.

Such diverse and compelling uses dictate a non-ending demand for the metal. The inventories on LME have fallen to fifteen year lows and currently represent less than one day of global consumption. Meanwhile there is news that Chinese companies such as Shanxi Taigang Stainless Steel Co. and Baoshan Iron & Steel Co. are planning to boost production 37 percent this year to about 7 million tons.

Nickel, the best performing commodity in last 13 months, gained 147 percent in 2006 and has risen 30 percent this year. Prices are five times higher than the average of $6,945 a ton during the 1990s. Sensing the opportunity investors and speculators have piled in their money; more than $11 billion of nickel futures are outstanding on the LME, which sets world benchmark prices.

At the same time the supply side constraints are growing, thus providing one of the reasons for price jump.

Many mines are seeing strikes by the workers, most notably in New Caledonia. Another reason is that the new mining capacity takes time to come on stream. There are scores of projects being put in process, but it will take years for them to come roaring down the markets. Some experts feel that even if all the currently committed projects were to move ahead as planned, the increase in nickel supply would exceed the increase in nickel demand by some 16,000 tonnes - but only in 2011.

Concerns about ecology are also causing further delays. Many countries are coming out with newer set of guidelines aimed at making mining much more eco-friendly. Owe it to this fact, a court in France recently ordered a CVRD-associate company in New Caledonia to halt the construction of part of its nickel plant for environmental reasons.

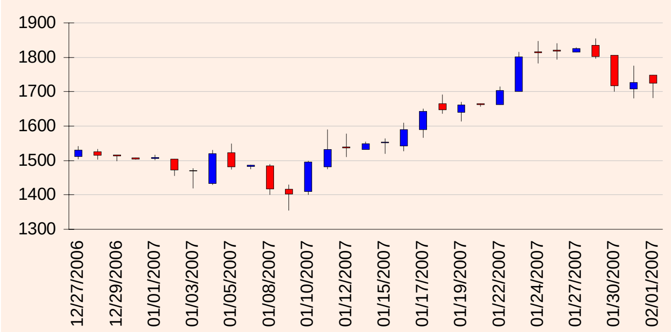
But there are many who are bearish on the metal. They are asking investors to exercise caution saying "Nickel's fall will be worse than the pace copper has seen." Copper which had been the darling of investors during the past year has dropped at least 25 percent this year.

The bearish camp claims that each time nickel prices doubled in a year during the past two decades, as they did in 2006, they've fallen the next year.

Another reason the bears cite is that stainless-steel producers are reducing the amount of the metal in their products. Although the method is not in vogue, production of nickel-free stainless steel now accounts for as much as a quarter of global output, up from 21 percent three years ago.

So which way the cookie will crumble? According to Sharekhan Research from here the upside may be limited with downside quite deep. Although stainless-steel production will expand 8 percent this year, guaranteeing good demand, the price, we feel is already quite high. Nickel has gained 30% percent this year on expectations of strong demand from China, the world's largest producer of stainless steel. Besides, the rebuilding of inventories by consumers is over and slower economic growth, particularly in the U.S., will reduce the demand for stainless steel.

Nickel (30 days)



Sharekhan Commodity Research view: **Neutral to Bearish**

COVER STORY

Gold set to command a good investment demand in 2007

Gold investing in India has become easy during past two decades. There was a time in our country when buying a bar of gold could lead a person to jail. Till less than two decades, the gold imports were banned and almost all the imports were effected by illegal channels. Smugglers flew or sailed from Dubai, Singapore and Hongkong, concealing gold bars in their shoes, belts, and even within their body, to smuggle the yellow metal inside India.

From them the gold reached to the jewellers spread around the country, and through them ultimately to the consumers. The involvement of smugglers and thugs discouraged lot of people, and many prospective buyers were dissuaded to invest in gold; they would rather invest their money in the bank than deal with people of dubious character.

There were many people who were interested not in the jewellery but just in the gold bars. They wanted gold as an investment vehicle and did not wish to spend more on the jewellery making charges. But even these people stay put since they did not like to strike a hush-hush relationship with the jewellers or smugglers to buy the contraband, and later carry the risk of being apprehended by the law-enforcing agencies.

> Gold has been probably the earliest investment vehicle known to mankind. No sooner the hunters-gatherers began settling down and took to cultivation of crops and raising of livestock, they began investing in gold, something which gave rise to gold jewellery.
>
> However during last two decades the rise of paper money and the paper investment instruments - the stocks, bonds, mutual funds, insurance, and debentures - around the world removed gold from people's investment radar. But things are changing again, and gold is finding approval as an investment instrument.
>
> Take for example the gold's price rise during the first half of 2006. At that time the physical demand was very weak. As gold continued its relentless climb from $520 an ounce during the first trading day of the year to $725 on May 11, few investors cared to take delivery or few women walked to the nearby jeweller. Yet the price continued to climb, a proof that the yellow metal was primarily running on support of investors' demand. all hues.

Today things have changed. With the imports of gold being liberalised in the aftermath of opening up the economy during 1991, the smuggling element has been done away with. Most of the imports as of now are through official channels, and 100% legal. As a result, the whispers have disappeared from the domestic gold market and a direct, bold salesmanship has taken over.

Consequently, today gold bars are exhibited by the gold jewellers in their display counters. Any customer can walk in with a wad of currency notes or a banker's cheque and get hold of a chunk of the Midas' metal.

Meanwhile, newer avenues are opening up for gold sale, banks for one. Indian Banks have realised the Indian emotions towards the Midas metal and have taken up gold coin marketing with a vigor hitherto unseen. Many banks have regular gold coin sales counters and display boards in their branches announcing day's gold prices. During Akshaya Tritiya last year, many banks opened special counters just to be able to cater to gold buyers.

> While overall imports have shown remarkable annual growth over the last two years, according to GFMS data, coin imports have substantially gone up. GFMS data for the third quarter of 2006 illustrates that demand for coin grew by more than double the rate of hoarding and jewellery.
>
> One reason for this shift is that during last couple of years the Indian banks have enhanced their efforts in retailing gold coins in various denominations. From as little as four grams investors can buy gold pieces weighing up to 100 grams, thus attracting customers of ICICI Bank was one of the first banks to plunge into gold coin retailing business, and since then there has been a herd of followers. As of now there are almost a dozen bank is offering coins struck specially in globally respected refineries in Switzerland and elsewhere.

There are some who buy because they have a marriage in the family, but there are also those who don't have one. They buy it as a safe investment bet. Some of them simply keep the bars in the locker for pure investment purposes. The class is very small, but there is one such, and according to industry sources, it is growing - specially in the wake of the phenomenal returns provided by gold during last couple of years.

Bullion buying has yet another outlet these days: through the commodity exchanges. There are three commodity exchanges which trade in different gold futures contracts. Any Indian person can open an account with a broker, buy the futures and then demand the delivery at the end of the contract limit. All transactions are transparent, hassle-free and done in the broad day light. No fishy dealings.

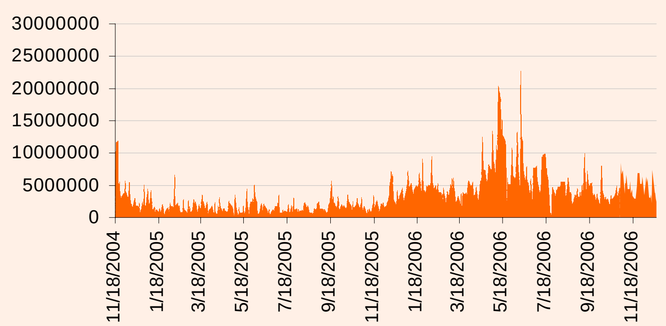
Futures trading often results in unintentional purchases of bullion. Sometimes an investor who buys the futures contract at a higher price is unwilling to square up his long position at the end of the contract period since the price is low. Unwilling to roll over, some of these people simply take the delivery and keep the bars in bank lockers.

Owe it to all these facts that World Gold Council (WGC) data shows that investment demand in India, though still smaller than jewellery, grew much faster in 2005.

According to a report in the Economic Times, "Investment-led buying accounted for consumption of 135 tonnes of gold last year(2005), up 34 percent over 2004, while jewellery demand was at 589 tonnes, up 14 percent on the previous year." The same report quoted the WGC managing director for the Indian subcontinent that "the investment demand would be higher this year (2006)."

Not just in India, around the globe, gold investment is on the rise. Owing to people's weak perception about the US Dollar and the increased volatility observed in the stock markets around the globe, investors are frequently looking at gold as a sound investment choice. It is widely believed that the greenback is headed downwards during the months and years to come, and since many people are losing faith in other fiat currencies as well, they are seeing gold as a dollar hedge/ fiat currency hedge.

Daily GLD share volume



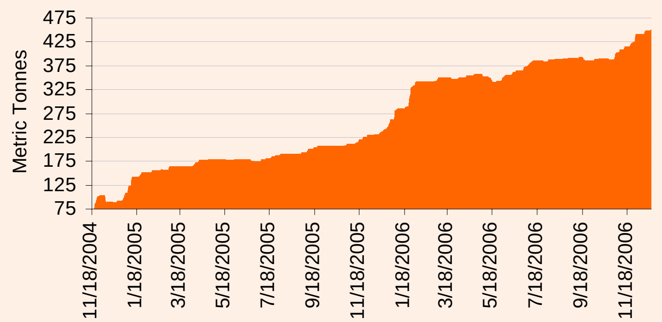
That apart, there are many investors who are turning to gold to protect worth of their wealth. They are concerned because of ceaseless increase in the money supply around the world. During the last year the money supply increased in the US by around 7%, in EU by 9% and in China by 16%. India is also seeing a rapid rise in money supply, the latest RBI statistics point out that M3 money supply grew at an astonishing rate of 21% during the last year.

Not surprisingly the investment demand is rising at a time when the US dollar is fetching more than 5% bank interest and Euro is providing above 3%+. Traditionally, the higher interest rates have meant a lower investment demand for gold since it doesn't pay any interest or dividend. This means that those who are investing in gold are confident that gold will provide much more returns that these interest rates.

Yet another factor pulling investors towards gold is the frequency and impact of terrorist activities. It is a foregone conclusion that the disturbances in geopolitical situation act favorably to the noble metal. Every time there is a terrorist strike or a political problem in the world, the investors turn towards gold. And since such incidences are becoming more frequent, there are many investors who find gold as a reliable investment, even during the periods of relative calm.

Even more remarkably, everywhere it has been observed that gold investors are usually sticky type; they don't give up their holdings easily - even if the price goes down a bit. This factor has been visible among the new investors as well. Even when gold goes through lean patches, investors continue to stay invested. A whole lot of investors today abound gold market who believe in "buy and hold" philosophy. Pension funds particularly subscribe to this philosophy.

Total NAV of gold



Gold is also becoming a choice among the institutional investors, particularly the pension funds, mutual funds, and hedge funds. Although they are yet to perk up their buying, the fund managers are increasingly aware about the diversification benefits of including gold in a portfolio. (Returns on gold are generally and fairly un-correlated with those on stocks and bonds.)

Many investors are coming to the precious metals markets with the perception that the fundamentals of the gold market are good. These are knowledgeable investors, who have pored through truckloads of data about the Midas Metals and are sure that the sentiment for demand is going to be positive in the years to come.

And last but not the least, the investment demand is going up due to evolution of Exchange Traded Funds. Though ETFs have been available for various investment forms, Gold ETFs have been in a league of their own. Within a span of two years, they have come to be recognized as a force to reckon with, amassing more than 12 billion US dollars within their kitty.

Although there are many ETFs focused on gold in international markets, the clear leader among them is StreetTracks Gold Trust ETF, symbolically known as GLD. Listed in New York, the ETF has been a success right from the day one. Investors put an estimated $550 million in GLD on its first trading day on the New York Stock Exchange on Nov. 18, 2004.

Gold ETFs have been gobbling up physical gold from the market steadily, and till January 2007 the GLD alone has cornered 450 tonnes or 14.5 million ounces, valued at 9.3 billion US dollars at the current price of $645 an ounce. Interestingly, the gold ETFs haven't actually taken away from the pool of physical buyers of pure gold. The physical buyers continue to buy as much quantities in the local markets. In other words ETFs have brought an entirely new class of investors to the gold markets. In still other words, the market has widened and broadened.

Having said that, I must emphasize that the real story is yet to unfold. The demand for ETF gold is yet to peak. There are lots of people who are unaware of the ETF concept, and there are many institutions yet to discover the potential of ETFs. Many funds are yet to change their mandate to let them invest in commodities in general and precious metals in particular.

Besides, really large institutional funds are still watching and waiting until ETF gold holding increase to the level which brings in the liquidity to move in and out of the market without causing a cyclone or inferno. Many major investment funds are waiting until the ETFs get big enough to handle their business in terms of track record and liquidity.

It is a matter of time before all such investors come aboard this new investment vehicle. When this happens, industry observers expect that the tonnage held by the ETFs will rise to that over 3,000 tonnes within next two-three years. While the amount may look insignificant, it must be remembered that this is more than one year of mining output. Surely such a drain on existing supplies will cause a noticeable impact on the gold price.

All in all, the metal Samuel Johnson referred as "The last corruption of degenerate man", looks set to command a good investment demand during the coming year.

Sharekhan Commodity Research view: **Bullish**

Investment demand in India

Investment scenario in gold is likely to perk up with the entry of gold ETFs. Recently Benchmark AMC launched its Gold Exchange Traded Fund scheme (from 15-23rd February). Gold BeES is an open-ended, Exchange listed scheme tracking domestic prices of gold through investments in physical gold. The new fund offer (NFO) starts on February 15 and closes on February 23.

Each unit of Gold BeES will be approximately equal to the price of one gram of gold. During the NFO there will be an entry load ranging from 1.5 per cent to 0 per cent, while no load would be charged on an ongoing basis. However, the investor will have to pay the brokerage charges applicable on the trade.

Total expense ratio of the fund will not exceed one per cent per annum.

On the taxation front the investors will be exempt from wealth tax but will have to pay long-term capital gains tax. This is likely to attract the buyers as buying physical bullion attracts wealth tax.

The minimum initial investment in the fund is Rs 10,000 and in multiples of Rs 1,000 thereafter.

The BeES will strive to provide returns that, before expenses, closely correspond to the market price of gold.

After the NFO, as Gold BeES will be listed on the NSE, investors will be able to buy or sell units of Gold BeES from the secondary market and a minimum of one unit can be bought or sold on the exchange.

The AMC will buy physical gold on behalf of the investors and arrange for its safe keeping. The custodian for the scheme will be The Bank of Nova Scotia and Citibank NA will do the fund accounting.

Quotable Quotes

- "Vote: The only commodity that is peddleable without a license"

  Mark Twain (American Humorist, Writer and Lecturer. 1835-1910)

- "Opinions are the cheapest commodities in the world."

- "Time is the scarcity, and it's the commodity we can't create any more of."

  Jim Mitchell

- "Economy is the basis of society. When the economy is stable, society develops. The ideal economy combines the spiritual and the material, and the best commodities to trade in are sincerity and love."

  Morihei Ueshiba

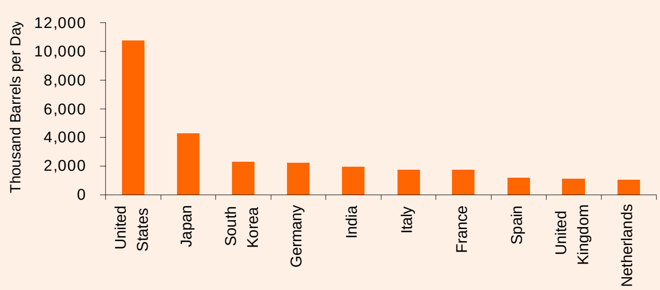
ENERGY WATCH

Crude in consolidation mode

As the year begins to gather momentum, crude oil prices are beginning to move up again. Since January lows of $52 a barrel they have silently and stealthily climbed to $60 (22/2/07). Translated in simple numbers, it means that the prices are presently about 20 per cent above the mid-January lows.

Simultaneously the experts are getting bullish about crude. According to them, the current year may happily surprise crude investors. They claim that the price fall from the fabled heights of $78 to $52 a barrel a couple of weeks back, doesn't mark the end of oil bull market. According to them, global oil demand is still on the rise and production is struggling to keep up. They are firmly of the opinion that the current decrease in price is nothing but a price adjustment period that will sink into the quicksand, almost before others can do anything about it.

India among the top importers of crude oil (2004)



Why they can be believed? First of all, there is no sign around the world that the consumption is decreasing. Some buffer stocks have been created, but nothing has been done by any government to bring oil consumption under control. Even China, where the Communist Party dictats are able to enforce the guiding policies, has failed to implement its program of reducing the consumption as stipulated.

Meanwhile, the production and sales of cars is going on unabated in our country as well. India this year achieved a milestone: it manufactured one million cars in one single calendar year.

Other countries are equally efficient in producing/marketing the cars. China is likely to pass Japan as the world's second-largest vehicle market this year, with sales soaring for cars of every size and shape.

Simultaneously China has more car brands now than the United States, as companies like Fiat and Citroën compete with General Motors, Ford, DaimlerChrysler, Toyota and Nissan in joint ventures with Chinese companies. And to make things even more enticing for the consumers, the automakers are increasing their output even faster than the 38 percent jump in car sales during the first three quarters of this year.

Here it must be added that the boom is not just limited to India and China. Auto expos around the South East Asia are packed with visitors, producers, and marketing execs. Car manufacturers across the region are offering inexpensive deals, something crucial in the region's burgeoning market where customers are cost conscious and not likely to be brand loyal.

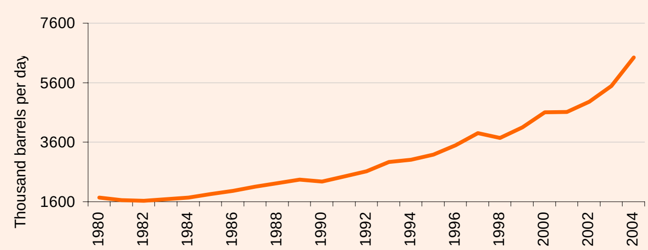
Meanwhile, United States continues to be the number one market for sales of cars, estimated to reach almost 16.7 million number this year. Total sales in the 18 countries of Western and Central Europe cumulatively are, coincidentally, expected to be 16.7 million.

On the supply front the news continues to be shaky. OPEC's recent cut amounting to half a million barrels a day from current levels effective February 1 is also seen as a bullish factor.

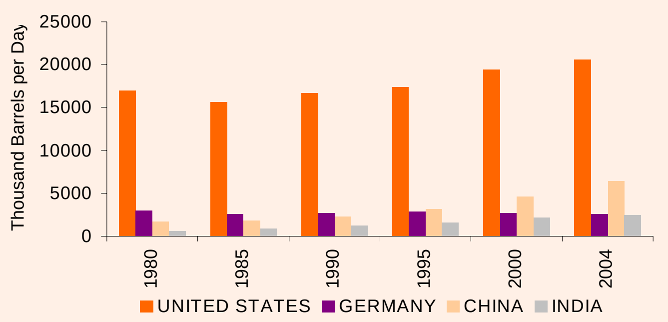
Even though the oil is produced around the world these days, the bulk still comes from the OPEC, the group that pumps more than a third of the world's oil. Goes without saying, OPEC still has the capacity to stall the growth of the global economy.

In 1973, OPEC stopped selling oil to the United States in protest of American support of Israel in the Yom Kippur or Ramadan War. This coincided with the peaking of U.S. domestic oil production. Without a supply of cheap energy, the US economy went into deep recession. At that time there were oil producers like Venezuela who could step in to fill the supply gap. These days there are no such producers to fill in the gap.

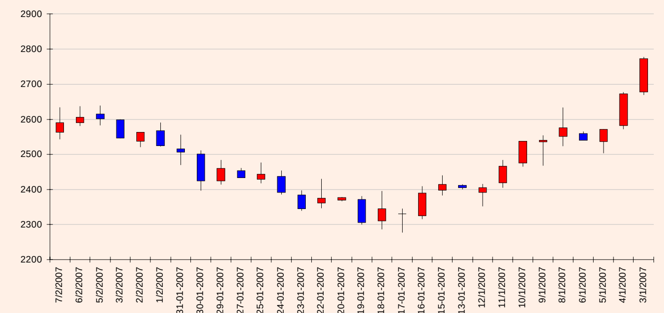
China's consumption of refined petroleum products



India among the biggest consumers of refined products



Crude Feb 2007 (MCX)



Meanwhile the global demand continues to spring up; it is expected to rise by 2.4 million bpd from the third quarter, according to the IEA. The boom in the Asian economies, largely driven by China and other smaller nations is not letting the demand subside. In IEA's words "The structural support of Chinese consumption, economic growth, is still strong and likely to remain so, at least in the short term." The Chinese capacity to soak up the extra production is in fact growing. No wonder the IEA feel that "Even if the U.S. economy were to slow down, the world economy (and global demand) are likely to hold their ground."

There is yet another reason for bullish expectations: the lower prices have been spurring consumption. Until September, the U.S. which was showing a leaner demand is witnessing a growth in offtake, which the analysts attribute to the cheaper prices at the pump.

Reasons enough why the industry observers feel the markets are in an idling mode, before they again go first in the drive and then cruise gear. And that is why many "buy and hold" investors who believe that markets will get tighter in the years to come as suppliers struggle to meet rising demand, feel the fall in price represents a buy opportunity.

Sharekhan Commodity Research view: **Neutral**

SHORT TAKES

Gold turns hot cake in “City of Gold”

According to World Gold Council's regional office in Dubai, sales figures in UAE increased by 53 per cent during fourth quarter of 2006 as compared to the same period in 2005. The retail gold sales in Gulf state went up from Dh1.1 billion to Dh1.7 billion in Q4, 2006.

Simultaneously, the UAE gold consumption in terms of tonnage increased from 17.6 tonnes in Q4 of 2005 to 19.1 tonnes in the same period of 2006.

This is the most remarkable growth in a quarter during past couple of years. Usually the growth has never gone beyond 25%. Having said that, it must be mentioned here that UAE is also known as the country with highest per capita gold purchases. While the per person consumption of gold is a measly 0.5 grams in China, and just above 1 gram in India, in UAE it is over thirty grams. Talking in unit of GDP, UAE buys more than 2 grams gold for every one thousand dollars of its GDP, the highest in the world; even Germany doesn't buy more than 0.5 grams.

As always, tourists have been an important source of gold purchases. According to the WGC report "UAE gold consumption in terms of tonnage was stable due to high tourist numbers in the third quarter compared to the same period of the previous year."

During last one and a half decade Dubai Shopping Festival has become a happy hunting ground for Indian shoppers. Every year hundreds of thousands of Indians fly to "City of Gold" to do their shopping of electronics, fabrics, watches, and of course gold. The amount of gold sold during these festivals is rising every year, and goes without mentioning, a lot of these purchases are made by Indians.

Tourist or no tourists, it is a well known fact that a great majority of customers in Dubai are basically Indians. The famous Gold Souk, which prides on having more than 20 tonnes of gold jewellery on the display of its shopping windows, is filled with Indian buyers at any time of the day. More than half the shops belong to Indian jewellers from Gujarat and Rajasthan.

Together these shops cater to more than five million Indians who work in Gulf rim countries, performing a wide variety of blue- and white-collar jobs. Every time they return home, they make sure that they purchase some gold jewellery. Often their travels are scheduled around some family marriage in India, compelling them to buy even more gold.

Till a decade and a half back the difference between Indian gold price and international one was sizeable, thus encouraging Indians to buy their jewellery abroad. All the official gold imports were banned and the Indian jewellers got their raw material through smuggling channels, often well established and very reliable. The mark up though was high, and was recovered from the consumers.

Goes without saying, the City of Gold will continue to sell gold like hot cakes.

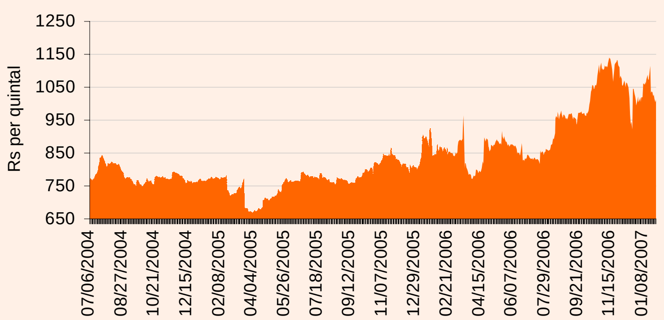
AGRO WATCH

Heat is on Indian wheat

An unusually hot climate is undoing all the advantage India was planning to garner from increased wheat sowing two months back. In spite of wheat sowing having crossed the 20 million hectares mark, a record 22.5 per cent more than the last year's area, wheat output continues to be under threat.

If temperatures do not drop over the next couple of days, there is a likelihood that the wheat crop may be impacted in Punjab, Haryana, Uttar Pradesh, Rajasthan and Madhya Pradesh. According to a report in the Economic Times "Not only is north India hot, it is also drier than before. For instance, Ludhiana has received only 6 mm rain this season compared to more than 20 mm last year. In Hissar, there has been no rainfall at all, compared with 13 mm last year."

Wheat (NCDEX)



And there is little protection that can be offered to farmers against such a change in weather. According to the Economic Times "Though farmers in Punjab and Haryana can use sprinklers to cool down their fields, irrigation is simply not an option for the one-hectare farmers of UP, which is India's biggest wheat producer."

The news is not so good in many other parts of the world. According to an expert "The global situation though stable right now may change in months to come. According to the current estimates, the production should be in excess of 600 million tonne compared to 589 million tonne last year. However this may change as weather fluctuations are not something that can be predicted."

The news from Australia is none too better. According to the Economic Times again "In Asia, the Australian government has said the country is preparing for its worst drought for 1,000 years. More than 50% of the country's agricultural areas have been drought-declared. The output of three main winter grains of wheat, barley and canola are expected to be down by 60% year-on-year, rice down by 80% and cotton lint down by more than 60%."

In India the prices have been steadily strong, and have made the farmers in a state recently threaten to stop selling their stock at government-fixed prices, which are usually lower than the those prevailing in the markets.

Global prices have also been high, driven by a shortage in production and increase in consumption. FAO's recent forecast of world wheat output in 2006 stands at roughly 592 million tonnes, almost 33 million tonnes, or 5.3 percent, down from 2005. Price rises have been supported by supply shortfalls due to setback in Australian wheat output as well as due to low global stocks.

Though FAO expects a turnaround, with increased winter plantings - as has been the case in India and elsewhere - and good growing conditions raising expectations for a strong rebound in 2007 harvests, at least the coming few months may witness wheat prices continue to rule firm. Reason enough why a report by J P Morgan Chase has been bullish on the grain. "Global wheat reserves will fall to 118.8 million tonnes on May 31, the lowest since 1982 because Australian production will drop 57% to 10.5 million tonnes and US output has declined 14%."

Leave aside wheat, other grain production is also a cause for worry. For example global production of coarse grains is lower by 2.1 per cent over last year, at 981 million tonnes. Maize output is lower by 2.2 per cent at 694 million tonnes. More than two billion people are used to consume coarse grains, and are likely to select either wheat or coarse grains depending upon various factors like availability and comparative price.

Similarly, rice growth is predicted to be affected by the typhoons, drought, flooding, diseases and insect attack. Rice again is staple for more than two billion people, most of them in Asia, and any stress in supply will only spur them to consume wheat.

Although Indian ministers have been shouting from the rooftops that there was no threat to country's food security, and that the available food grain stocks are much higher than the mandatory buffer norms, the fact is everybody in the trade knows about the ensuing shortages.

India has already begun importing wheat, and according to informed sources there are problems even though the stocks have landed in India. There have been reports about contamination on account of the use of substandard packing, thus feeding the speculations that India was going to be a sustained customer in the global markets. And as the trend has been; the prices harden smartly any time India is a buyer.

India is forced to import substantial quantities of wheat since other grains' output is also markedly down. For example the production of corn, which is the third most important cereal crop in India after wheat and rice, has fallen from 12.4m tonnes to 11.5m tonnes this year, a significant reduction in the face of overall declining grain output.

While supply has fallen to 11.5m tonnes, demand is rising rapidly and pegged currently at 14m tonnes. Although the demand for corn in India comes mainly from the poultry, meat and dairy industries for use as animal feed, it is also consumed as regular food by people. In fact in many regions corn is the staple, not without reason; traditionally India is among the top 10 global producers of corn.

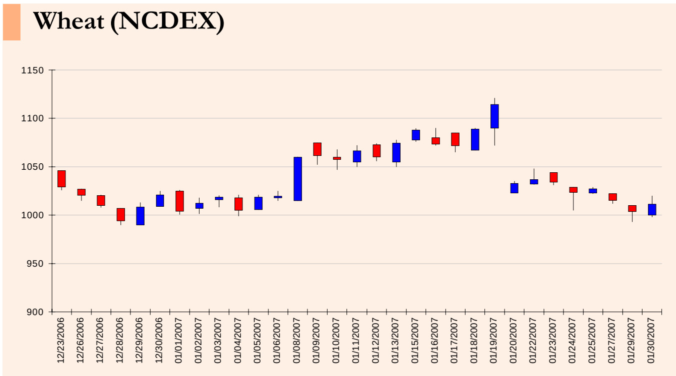
Globally corn has been one of the best performer on the commodity bourses this year. Corn prices have reached levels not seen for a decade, according to FAO's latest Food Outlook report. Corn market fundamentals favour firm prices given buoyant demand by China for feed purposes and for bioethanol use in the US.

If industrial use, mainly for ethanol, continues to grow at the current pace, it may take more than one good crop season for prices to retreat significantly from their current highs, the report said.

Keeping in mind all these developments, it is evident that wheat price may first see wide fluctuations this year and then possibly rise. To begin with many Indian farmers - those who have sufficient cushion to hold back their production - will not like to sell it below 850 rupees a quintal. Any farmer with some monetary backing may well horde his crop. After all we have seen recently how plantation owners in Kerala have been holding their rubber production in expectation of better price realisation.

And if the government was to import the wheat, which is will, it won't get it cheaper. The imported wheat would land here at not less than Rs 11,500 a tonne. In other words, prices during the later half of the current year may well be 1-15-20% higher from now.

With Indian crop conditions and import dependence becoming increasingly clear, world wheat prices are unlikely to retreat. In fact as the experience - or rather the bitter experience shows - wheat prices leapfrog on international bourses the moment India enters as buyer. Not surprising, wheat is being cited as one of the attractive buys among commodity investors this year.



Sharekhan Commodity Research view: **Neutral**

COMMODITY QUERY

What are soft and hard commodities?

In global parlance commodities are said to come in two types: soft and hard. Any commodity that can be grown or raised is termed as a soft commodity, and any commodity that needs to be mine or excavated is called a hard commodity.

Commodities such as coffee, cotton, cocoa, orange juice and hogs are examples of soft commodities. Softs are renewable. Crops can be re-grown, and typically in the same spot as the previous crop. Similarly meat commodities are the result of animal breeding that is remarkably accurate in its regrowth.

Although the softs are not infinite they are certainly non-finite in nature. The general presumption, given the experience of last couple of thousand years, is that the crops will always be grown. (Although according to many, this is a very optimistic and silly view, specially in the wake of global warming and all the associated ecological disasters.)

Even though non-finite, the softs have their price influenced by various factors, the most important among which is demand/supply gap. Weather, disease, geopolitical unrest and labor are examples of some of these factors.

The hard commodities consist of crude oil, furnace oil, metals, plastics, and so on. These products not only require extensive capital expenditure in order to retrieve them from the earth, but also need lots of time to put these projects on mainstream. These commodities are finite in nature and are not renewable.

Jigar Pandit, Mumbai

Oilseed production seen skidding in 2007

With a massive one million hectare shrinkage in the total acreage under oilseeds cultivation during the kharif '06 season, the edible oil industry is crying for increased oilseeds acreage and better pricing formula, to encourage the farmers. Crop size has reduced to critical levels and the oil mills are often lying idle. According to a recent report "Most mills in Gujarat are closed because they have no groundnut left to crush", simply because shortage of groundnut.

As per industry projections, the country is expected to produce 12.8 million tonne of oilseeds during 2006-07 kharif sowing season (June-October), which means a reduction of around 6.5 per cent compared to last year.

Although India has the world's fourth largest edible oil economy, and produces almost 10 per cent of world oilseed output, it is forced to import substantial quantity of edible oils every year, primarily due to shortage in oilseeds production. Severe population pressure, coupled with decreasing oilseeds output has meant that India must import about 43% of its edible oil needs.

While the reduction is across the board, some crops are showing more losses than others. For example the kharif groundnut production is seen dropped to 3.6 million tonne in 2006-07 (Nov-Oct) oil year, from 4.4 million tonne a year ago.

As if that was not enough, the rabi crop also looks set to have much smaller oilseeds acreage. This time around, the oilseeds are losing the acreage to wheat whose price rise a couple of months back has lured farmers like bees around a nectar-laden flower. The reports are all over the media about how there has been a significant drop in the area sown under all rabi oilseeds, led by rapeseed-mustard.

Wheat has not always been the reason to avoid oilseeds, though. For example in Madhya Pradesh, the farmers have diverted rapeseed-mustard area to chana, which has been in the limelight almost throughout the past year.

In Gujarat, the area under groundnut crop shrunk as many oilseed growers of the previous season have this time round switched over to cotton cultivation.

Other significant reason in some regions has been the insufficient rains or improper weather at the time of sowing. For example, the dry spell in early part of the current monsoon discouraged many farmers in Andhra Pradesh to take up groundnut cultivation.

India's total area under nine major oilseeds usually is 22-25 million hectares each year. However due to farmers shifting to other crops - because of better price realisation - Indian edible oil industry is faced with growing oilseeds shortages.

Of course what is adding to the gloom is the news that the situation is not rosy throughout the world. Oilseed stocks are witnessing a fall on a global level. According to a report by Oil World, "2006/07 will be the first in three years in which world oilseed stocks will decline."

World production of oilseeds

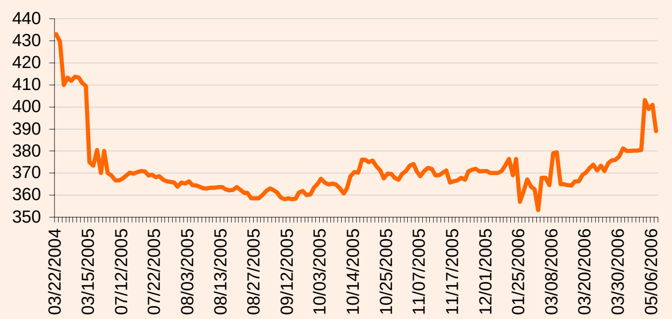
	2005/06 f'cast
Soybeans	220.4
Cottonseed	42.1
Rapeseed	44.8
Groundnuts (unshelled)	35.1
Sunflowerseed	27.6
Palm kernels	9.2
Copra	5
Others	10.6
Total	394.8
(Million Tonnes)	

Then there are cross-sectoral price movements. "The recent rally in palm oil and soya oil prices has improved import demand for rapeseed & canola", according to the Oil World.

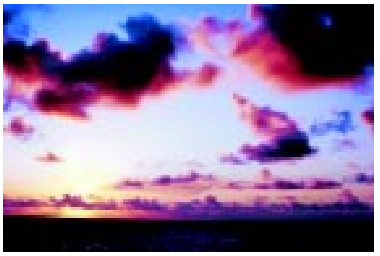
And why the edible oil prices are hardening? Because of a "significant discrepancy between production and demand developing this season", according to the Weekly. "For the first time in four years world demand will exceed production and require a sharp reduction of stocks."

The most popular oilseeds cultivated in India are groundnut, mustard, sesame, safflower, linseed, nigerseed, castorseed, soyabean and sunflower, and the industry claims that the government has failed to provide adequate importance to the entire sector.

RBD Palmolein



Sharekhan Commodity Research view: **Bullish**



WEATHER WATCH

Agri commodity markets are extremely sensitive to weather reports. Here is an estimate of what lies ahead for key commodities with reference to prevailing weather conditions (as on 22nd Feb, 2007)

BLACK PEPPER

Warm and dry weather in Kerala is not favourable for fresh vines as moisture stress and high temperature often results in crop mortality. However pepper in berry development to harvesting stage (as is the case in Tamil Nadu) will have no effect of increased warmth and dryness.

CHILLI

With dry and warm weather prevailing in Andhra Pradesh and Tamil Nadu, the outlook for chilli seems favourable for a better crop. Increased heat may also help soak up extra moisture and thus obviate pest problem to some extent. Harvesting and arrivals happen to be smooth with no adverse weather projected.

SESAME

The plant is highly drought resistant and grows best in areas where cotton does well, however it has a very low salt tolerance for wet conditions. Given this background, it is easy to understand why mid February rains interspersed with hailstorms and high wind may have adversely affected the seed quality, and consequently the yield. With the crop being in flowering to seed filling stage, there can be a risk of pests if high humidity was to prevail.

SUGAR-CANE

With climatic conditions and soil moisture being optimum for planting of spring sugarcane in northern and central plains hopes are high for a better crop. Weather is also favouring sugarcane in the middle of harvesting stage in key growing states like UP and Maharashtra. Cold conditions in north India is likely to help in increased sugar recovery. Weather outlook favours harvesting of matured can in Gujarat and Tamil Nadu. With rising temperature and optimum soil moisture, weather is turning favourable for planting spring crop in certain parts of Maharashtra and Karnataka.

MUSTARD

Light showers expected in Punjab, Haryana, and Rajasthan during the third/fourth week of February are likely to affect late sown crop, now standing in the fields in flowering stage. Early crop in pod formation and filling stage are nearing maturity. This crop will benefit from the expected showers. Chances of mildew infestation likely as moist conditions are likely to prevail after the showers.

WHEAT

Rain in north India over the second week of February has had a positive impact. Although there was some damage in a couple of regions, rainfall far outweighs damage caused by hailstorm/wind in pockets.

Passing showers expected in Punjab, Haryana and parts of Uttar Pradesh during third week Feb will give a new fillip to the hopes of better harvest. Standing crop is likely to benefit the most. Cool weather and optimum moisture remains favourable for healthy crop growth. Low temperature will help in prolonged seed setting and will boost the size as well as yield. Increased acreage with improved yield of wheat will mean lower imports and cheers to farmers.

CHANA

Chickpea harvesting has resumed and is likely to pick up in MP. Though rain and hailstorms have affected the maturing crop in MP and Rajasthan, damage is limited. But seed quality may suffer in the already harvested crop if it was not protected. Arrivals are expected to increase with the passing days, something which is keeping the prices capped for the time being.

Quotable Quotes

- "A good prince will tax as lightly as possible those commodities which are used by the poorest members of society: grain, bread, beer, wine, clothing, and all other staples without which human life could not exist"

  Desiderius Erasmus
  (Dutch Priest, Humanist and Editor of the New Testament, 1469-1536)

- "The ability to deal with people is as purchasable a commodity as sugar or coffee and I will pay more for that ability than for any other under the sun."

  John D. Rockefeller
  (American Industrialist and Philanthropist, 1839-1937)

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