INSIDE METALS

Friday, August 2, 2013

CHART OF THE DAY

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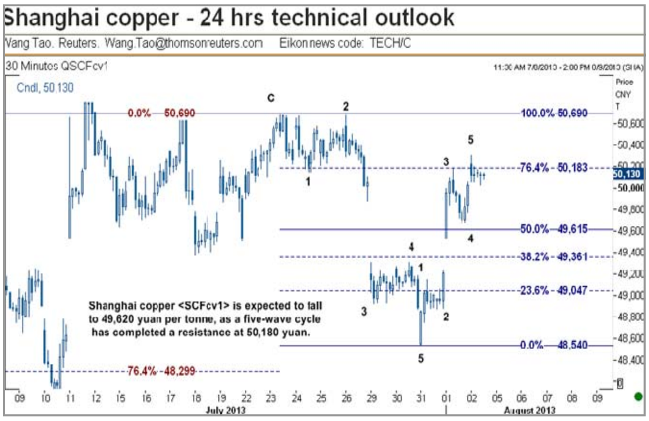

Click here for LME charts

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ALUMINIUM:

- AMAG sees lower profit as aluminium prices fall
- Goldman's aluminium offer may soothe but leave costs high
- Ormet cutting Ohio aluminum operations, cites high power rates

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- China relaxes futures grip as steelmakers test swaps market

FEATURE

COLUMN-Unravelling the aluminium market's problem

Everyone involved in the aluminium market knows that it is a malfunctioning market. Producers know it. Consumers know it. The London Metal Exchange (LME), which sets the global benchmark price of the light metal, knows it. Even the LME warehousing companies, prime suspects for the market's problems, know it.

Andy Home is a Reuters columnist. The opinions expressed are his own

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TODAY'S MARKETS

BASE METALS: London copper edged down on profit taking, but was heading for the first weekly gain in three, supported by signs of stabilisation in global factory sector growth and the accommodative stance of top central banks.

"Our Chinese economists have highlighted that order books are still pretty slow and the smaller-sized businesses are still struggling with tight credit conditions," said analyst Natalie Rampono of ANZ in Melbourne.

PRECIOUS METALS: Gold fell for a fifth session heading for its biggest weekly loss in a month as strong U.S. economic data raised fears the Federal Reserve may start to taper its commodities-supportive stimulus measures.

"We are still expecting the Fed to taper its QE in September," said Barnabas Gan, an analyst at OCBC Bank, referring to quantitative easing.

FOREX: The dollar held steady versus the yen on Friday, clinging to hefty gains made the previous day after better-than-expected U.S. data stirred hopes for an upbeat nonfarm payrolls report.

"I think you have to be careful this time," said Daisuke Karakama, market economist for Mizuho Bank in Tokyo. "There was talk in the market yesterday that the number could be about 205,000 or 210,000, so I get the sense that these types of numbers have already been factored in."

THOMSON REUTERS

FEATURE

COLUMN-Unravelling the aluminium market's problem

By Andy Home

LONDON, Aug 1 (Reuters) - Everyone involved in the aluminium market knows that it is a malfunctioning market.

Producers know it. Consumers know it. The London Metal Exchange (LME), which sets the global benchmark price of the light metal, knows it. Even the LME warehousing companies, prime suspects for the market's problems, know it.

And now the regulators, belatedly many would suggest, have woken up to the fact that something is not right.

The European Commission has been on a discreet fact-finding exercise, while in the United States, there is growing pressure on the Commodity Futures Trading Commission to launch an official investigation.

Even the British regulator, the Financial Conduct Authority (FCA), is considering an investigation. Given the laissez-faire attitude of the FCA when it comes to wholesale markets, that in itself is evidence that something is awry.

Aluminium's dysfunctional dynamics have made it a focal point in the bigger debate surrounding Wall Street banks' involvement in commodity markets, particularly their ownership of physical assets, and particularly, when it comes to aluminium, LME warehouses.

That something is wrong is obvious. That it is something to do with the queues to load out aluminium from LME warehouse locations such as Detroit is also obvious.

But separating the causes from the symptoms of this market's malaise is very tricky indeed.

WHAT'S THE PROBLEM?

Is this about manufacturers not being able to get enough metal to run their plants?

It is about manufacturers paying too high a price for their metal?

Is this market being systematically manipulated by the companies that own the LME warehouses and that are profiting from those long queues to access metal?

If you were to believe Timothy Weiner, global purchasing manager at U.S. brewing company and major aluminium user MillerCoors LLC, the answers to those questions are yes, yes and quite possibly.

Weiner was last week testifying before a U.S. Senate Committee hearing on Wall Street's ownership of physical assets. Here are some key soundbites from his prepared statement.

"My company and other manufacturers can no longer plan to buy the aluminum we need directly from aluminum producers."

"Aluminum users like MillerCoors are being forced to wait in some cases over 18 months to take physical delivery due to the LME warehouse practices or pay the high physical premium to get aluminum today."

"Aluminum prices have become inflated and this flows directly through to the price of can sheet."

"U.S. bank holding companies have effective control of the LME, and they have created a bottleneck which limits the supply of aluminum."

He also threw something of a hand grenade into an already heated debate with the claim that "the LME warehouse rules have imposed an additional $3 billion expense on companies that purchase aluminum."

Cue predictable outrage from U.S. lawmakers that Wall Street, led by Goldman Sachs , the bank that everyone loves to hate and owner of Metro, dominant warehouse operator in Detroit, is once again putting one over Main Street.

I CAN'T GET NO ALUMINIUM?

So are U.S. manufacturers struggling to keep their plants open for want of physical aluminium?

In a market that is carrying five and a half million tonnes of visible stocks on the LME and a whole lot more of invisible stocks? In a market that is still, most analysts agree, generating surplus metal day in and day out?

No. And you don't need to take my word for it.

Most of the aluminium purchased by big end-users such as MillerCoors is sourced, either directly or indirectly, depending on the length of the supply chain, from producers.

And producers seem more than ready to help.

"People are complaining about the metal availability, I don't think that has ever been an issue in the aluminum market," noted Klaus Kleinfeld, chairman and chief executive of Alcoa , the largest producer in the United States, speaking on the company's Q2 conference call.

"And frankly, if there's somebody who hasn't got metal available, you can send me an e-mail, give me a call and we'll solve that."

No purchasing manager, least of all one working for a company as big as MillerCoors, could ever rely on the LME system as a core component of supply.

The LME is inherently skewed towards being a "market of last resort" for the producer, never the consumer.

When you buy physical metal from the LME, you get it where the seller chooses. Forget Detroit. You're just as likely to find yourself the owner of a batch of material sitting in Malaysia. Swapping it out for an LME location nearer you always comes at additional cost.

So how many aluminium end-users are really stuck in that infamous Detroit queue?

Goldman Sachs itself has just thrown down the gauntlet by offering any manufacturer owning metal stuck in the queue prompt aluminium. At zero premium!

FEATURE *(Continued)*

Given there are over 930,000 tonnes awaiting load-out in Detroit, that's a mighty generous offer.

Except that Goldman knows who's in the queue and has obviously decided that the number of manufacturers, as opposed to banks, hedge funds and traders, is so small that it's a financially insignificant hit.

Indeed, as of yesterday no-one had taken up the offer.

QUESTION(S) OF PRICE

So, if this problem is not one of physical availability, it must be one of price.

But that is also a strange contention, given that the price of benchmark LME three-month aluminium is currently trading around $1,800 per tonne.

That's the lowest it's been since 2009, when the market was still reeling from the Global Financial Crisis and the Great Manufacturing Contraction that followed close on its heels.

It's a price at which many of the world's producers are losing money.

In fact, aluminium consumers have been buying at a price close to or below the top end of the cost curve for many years.

Copper consumers can only dream! Look no further to understand why the light metal has steadily been taking market share from the red metal in many applications.

So, if it's not about outright price, it must be about physical premiums, which have risen as those queues in Detroit have grown.

Not that it makes much difference to consumers' gross price. As Goldman pointed out in its statement on Wednesday, the delivered price of metal, LME basis plus premium, has still fallen around 40 percent since 2006.

Adding the current U.S. Midwest premium of around $260 per tonne onto the LME basis price generates a delivered price at which many producers are still losing money.

What's really vexing MillerCoors and other manufacturers is the shifting components of the delivered price with the premium accounting for a rising portion.

That's a major headache because while variations in the LME price can be hedged, those in the physical premium can't be. Which means that the premium is passed all the way down the supply chain from producer to sheet manufacturer to end user.

Even that statement comes with a caveat, though, since there is a fledgling OTC market in the aluminium premium as a standalone trade, one which end-users such as MillerCoors haven't apparently tapped.

THE GREAT EXPERIMENT

But if it's the physical premium that is the real underlying problem, it's one that should be fixed just as soon as the LME's new warehouse rules come into force next year.

The rules link load-in rates to load-out rates and are in essence intended to reduce those queues to a maximum 100 calendar days. They are still subject to consultation so that somewhat random figure may change. The core idea is that by capping the queues, warehouse operators will generate less revenue from them and will therefore have to reduce "freight incentives" to attract new metal.

Since those incentives have become the de-facto floor for physical premiums, premiums must therefore start falling.

Problem solved!

Or will it be?

Not everyone is so sure. A growing number of analysts are now predicting that while premiums should start coming down, they may not do so as much as consumers might like.

Indeed, some such as Lloyd O'Carroll of Davenport and Co. argue that they might not come down at all.

"The specifics of warehouse behavior can exacerbate but do not cause high premiums, therefore we think rules changes that only affect warehouses will have little impact on rising physical premiums." ("Proposed LME Rule Change No Obstacle to Our Bullish Physical Premiums Outlook", July 22, 2013)

The reason, O'Carroll argues, is that LME queues are the symptom not the cause of rising premiums.

"Long queues at LME warehouses, are a result of stock financing - an arbitrage that requires a wide contango and low interest rates."

Which brings us back to who is really stuck in that 930,000-tonne queue at Detroit.

It's not end users such as MillerCoors. It's banks, hedge funds and traders all wanting a bit of the stocks financing action.

Since the key variable in the profitability of the finance trade is the cost of storage, all that metal is moving off the LME to lower-cost storage.

Where it won't be available to manufacturers either.

Moreover, stocks financiers will still bid for metal, whether it's via the LME system or directly with producers, just as long as the trade remains profitable.

Is it stocks-financing or warehouse queues that is the key determinant of physical premium? Most likely both, but which is the most powerful driver?

In truth, no-one knows.

But, assuming the LME goes ahead with its rule change, we're about to find out. It will be one of the great experiments in commodity pricing.

If premiums fall back to historic norms, say around $100 per tonne for U.S. Midwest delivery, we'll know it was indeed the queues that were the defining driver. If they don't, we'll know it was stocks-financing.

FEATURE *(Continued)*

BLAME BERNANKE OR BLAME YOURSELVES?

The attractiveness of the stocks-financing trade, though, points to the real underlying problem in the aluminium market.

It is predicated on three components. Contango in the LME forward curve. The cost of money. The cost of storage. If the first is greater than the other two, it is a profitable trade.

Obviously, our current looking-glass world of near-zero interest rates helps. The cost of money is negligible, particularly for the world's biggest banks with a direct line to U.S. Federal Reserve funds.

Outgoing LME Chief Executive Martin Abbott has repeatedly told the market's users that rather than blaming him for the mass movement of aluminium out of exchange warehouses, they should blame Fed chairman Ben Bernanke, who has championed the cause of quantitative easing and generated a wave of "free money" in search of a profitable home.

But what about the other component, that contango which has been there for so long and is still wide enough to generate a profitable trade for stocks-financiers.

It's there because this is a market that has generated and still generates so much surplus metal.

It's been that way for years, which is why there's so much aluminium gathering dust in warehouses around the world. And only a fraction of it in LME warehouses.

Loss-making smelters are subsidised by governments. They are being subsidised right now in China, the world's largest producer. And they are being subsidised right now in Western countries that in theory espouse free-market principles.

A few companies, such as Alcoa and Russian giant UC Rusal , are adjusting output. Many others aren't.

Until this market collectively learns to discipline itself, it will keep on accumulating surplus. While it does, stocks-financiers will continue soaking up more units in competition with end-users such as MillerCoors.

One day the whole lot will come crashing down in an avalanche of unwanted metal.

Timothy Weiner will be then able to buy his aluminium at a cheaper price. He may want to consider, though, at what cost to his market's supply chain.

--Andy Home is a Reuters columnist. The opinions expressed are his own--

GENERAL NEWS

Freeport Indonesia says underground mine running at 50 pct capacity

JAKARTA, Aug 2 (Reuters) - Underground production at Freeport McMoRan Copper and Gold Inc's Indonesian unit is running at 50 percent of capacity, a spokeswoman said, adding that it would take "a couple of months" before full capacity would be reached.

A training tunnel cave-in killed 28 people at the world's second-biggest copper mine in May, shutting operations across the mine site for weeks while safety investigations were carried out.

Open-pit mining has been running at full capacity since July 4, while underground operations re-started in early July. The Arizona-based firm had expected full-capacity to take one month.

"The underground mining has not been running at full capacity," a spokeswoman said in an email in response to questions from Reuters late on Thursday. "It will take up to a couple of months before we are able to produce at full capacity.

"Currently our ramping up progress is at approximately 50 percent at our underground mine," she said, adding that the force majeure status had not been lifted and that the company had not achieved full shipments capacity.

The open-pit mine normally produces between 140,000 tonnes and 150,000 tonnes of ore per day, while output from the underground operations is 80,000 tonnes.

MARKET NEWS

AMAG sees lower profit as aluminium prices fall

VIENNA, Aug 2 (Reuters) - Austria Metall AG (AMAG) forecast a fall in core profit of up to 13 percent this year as aluminium prices fall and reported a 10 percent drop in the second quarter, though this was not as severe as expected.

AMAG, which is 54 percent owned by a consortium of B&C Industrieholding, Oberbank and the AMAG employees' foundation, said its three divisions had run at full capacity in the first half and it expected this to continue in the third quarter.

"The management expects a positive year from an operational point of view, although the factors ... like (the) aluminium price and pressure on margins are likely to result in a year-on-year decline in profit," it said in a statement.

AMAG said it expected full-year earnings before interest, tax, depreciation and amortisation (EBITDA) of between 116 and 121 million euros ($154 and $160 million), down from 134 million in 2012.

The company, which produces primary and liquid aluminium as well as aluminium products for the aircraft and automotive industries, said the average aluminium price had fallen 8 percent in the first half.

The company's second-quarter results beat average forecasts in a Reuters poll on all levels, with stable shipments of 93,700 tonnes, sales down 6 percent to 210 million euros and net income after taxes down 8 percent to 19 million euros.

Analysts had on average expected 16.7 million euros net after tax.

Goldman's aluminium offer may soothe but leave costs high

By Susan Thomas and Silvia Antonioli

LONDON, Aug 1 (Reuters) - Goldman Sachs' olive branch to beleaguered metals customers will do little to help bring down the high cost of securing aluminium, but even critics praised the proposal as a smart move to placate regulators and silence complaints.

Goldman responded to mounting political pressure and regulatory scrutiny of its Metro International metals business on Wednesday, by offering customers immediate access to aluminum stored in its warehouses.

In a statement outlining the bank's proposals to cut waiting times at all London Metal Exchange-registered warehouses, Goldman said it would let major consumers swap aluminum held in its warehouses for metal the bank has acquired, without the need to pay a steep cash premium.

"With all this pressure from regulators it looks like Goldman wants to come clean," Kamil Wlazly, a senior analyst at Metal Bulletin Research, said.

"But aluminium queues were one of the reasons why aluminium consumers have increasingly decided to shy away from procuring metal through the LME warehousing network."

Novelis Inc , the world's biggest maker of flat-rolled aluminum used to make beverage cans, received Goldman's offer last week, but said it is of "no benefit" to the company or other industrial users.

"We believe that other physical users of aluminum, like Novelis, are unlikely to be in the queue because no manufacturing business can tolerate a 19-month delay between buying metal and achieving delivery," said Nick Madden, chief supply chain officer, in an email to Reuters.

Madden, a longtime critic of the warehouse system, said he stopped securing supplies from warehouses in 2011 after waiting five months to get metal from Metro's Detroit facility for its Oswego, New York plant. The wait time has since ballooned.

Customers and U.S. lawmakers have accused Goldman Sachs and other warehouse owners of artificially inflating wait times and lines to boost rents for warehouse owners and cause metal costs to rise. One major customer estimated the delays have cost consumers more than $3 billion.

Warehouse owners and outgoing LME CEO Martin Abbott have said the complaints over long lines are unjustified, arguing there is no shortage of metal.

Instead, they said the long lines have been created by traders trying to move metal to rival warehouses that are offering financial incentives in a bid to boost their own rental income.

Madden said Goldman's offer does not deal with the record high physical prices being paid by steelmakers and carmakers and other industrial customers, even though the market is in a chronic surplus.

"We believe the focus should remain on the warehouse ownership issue and the reform of LME warehousing rules," Madden said.

CLEVER BUSINESS

"I think this proposal is a very smart move on Goldman's part," said one source with knowledge of the warehousing business. "They have always claimed that the objections from the consumers are spurious because they are not the ones that are actually in the queues."

Goldman said its offer applies only to large metal consumers like carmakers and soft drink producers, not to financial traders like hedge funds, or rival merchant commodity traders like Glencore Xstrata or Trafigura .

"If no-one takes them up on this, they turn around and say there you are, told you! Nobody needs to swap warrants to take physical delivery," the first source said. "To people not really in the know, they will say that's great, so it's a clever piece of business."

MARKET NEWS *(Continued)*

In testimony to the U.S. Senate banking committee last week, brewer MillerCoors LLC complained aluminium users like themselves were being forced to wait in some cases over 18 months to take physical delivery of metal, or pay the high physical premium to get aluminium today.

Goldman President Gary Cohn told CNBC television on Wednesday that no consumers had stepped forward to take up the offer.

This is not surprising, consumers said. Most end users have purchasing contracts with producers and do not have to queue for metal, but they do end up paying the price of the metal being tied up and unavailable.

"Packaging producers buy aluminium sheet so they don't take aluminium from LME warehouses, but they still suffer the consequences of the queues at warehouses propping up the premium," Gino Schiona, director general of Italian aluminium packaging association CiAl.

"The concentration of metal in warehouses and the rising premiums smell of speculation."

The queues have caused the price premium on some metals, like oversupplied aluminum and zinc, to surge, prompting accusations that the banks and traders that own storage facilities are artificially inflating prices and distorting supplies.

"In terms of premiums, there is no big change on the ground. Maybe a very gradual reduction but nothing steep," the European trader said. "If you want to buy aluminium you will still struggle to find any cheap metal. I can't find anybody who has drastically reduced their premium."

Under mounting pressure to ease the problem with wait times, the Hong Kong Exchanges and Clearing Ltd owned LME announced on July 1 sweeping reform of its warehousing policy, its third attempt to placate angry users. If approved, those changes will come into effect in April.

And it might just work.

The LME's warehousing committee, which includes Metro and Glencore's Pacorini warehousing firm, held an extraordinary meeting this week, and all but one of its members voted in favour of the new deal, three sources with knowledge of the matter said.

"That is a big accomplishment," said one of the sources.

Ormet cutting Ohio aluminum operations, cites high power rates

By Carole Vaporean

NEW YORK, Aug 1 (Reuters) - Ormet Corp was beginning on Thursday to shut down half of the existing operations at its lone 260,000-tonne-per-year aluminum smelter at Hannibal, Ohio, according to documents filed a day earlier with Ohio state utility regulators.

Low metal prices and high power rates prompted the decision, Chief Executive officer Mike Tanchuk said in a notice posted on the aluminum producer's website. On Wednesday, the Public Utilities Commission of Ohio denied Ormet's request for an emergency reduction in electricity rates.

While it did not grant the emergency reduction, the commission still plans to consider lower rates for Ormet at a full hearing on Aug. 27.

Late on Wednesday, Ormet submitted a motion asking that payment of its August and September power bills be deferred to provide liquidity for the aluminum producer to operate its Hannibal, Ohio aluminum smelter.

Deferral would also give the commission time to conduct a full hearing on Ormet's requested relief, regulatory documents said.

Ormet, which has filed for bankruptcy protection, needs "immediate relief from AEP Ohio payments due in August and September, 2013 to continue operating on a limited basis at its facilities in Hannibal, Ohio," and to keep it from shutting down all remaining operations by early September, the filing said.

The Ohio facility is Ormet's only aluminum smelter. The company also operates an alumina refinery in Burnside, Louisiana that is not affected by the AEP Ohio power agreement.

Ormet had sought an expedited ruling to cut its power rates, but the commission denied the request for emergency relief and affirmed its agreement with AEP Ohio, a unit of American Electric Power Service Corp .

At Wednesday's hearing, the PUCO commissioner said the commission thought the issues pertaining to Ormet's power rate application required more in-depth discussion at the formal hearing set for Aug. 27. "The consequence of this decision is Ormet must immediately begin the shutdown of half of our existing operations to conserve cash," said Mike Tanchuk, Chief Executive Officer and President in its website posting.

Ormet filed for bankruptcy on Feb. 25, 2013 due to low metal prices and high power costs.

The Ohio Power industrial rate, which establishes the base rate for Ormet to procure power, increased to $62.83 per megawatt hour in June from $39.66 per megawatt hour when the company's Unique Arrangement was established in 2009 with AEP Ohio, according to Ormet's notice.

Lowering those rates is one of several requests that will be considered on Aug. 27 in its efforts to restructure its power agreement.

Nickel producers fend off output cuts as losses mount

By Melanie Burton and James Regan

SINGAPORE/SYDNEY Aug 2 (Reuters) - Nickel miners are clinging to plans to maintain production, despite a growing supply glut and prices around four-year lows, raising the risk of more writedowns and losses being unveiled in the current financial reporting season.

MARKET NEWS *(Continued)*

France's Eramet this week reported a first-half operating loss and warned the second half would be worse due to weak nickel prices, while other top producers such as Vale SA , Glencore Xstrata and BHP Billiton report in the next few weeks.

Between a quarter to a half of the nickel sector could be running at a loss, according to industry estimates, hit by weak demand from China, the world's top producer and consumer of stainless steel. Nickel is a key component of stainless steel.

Nonetheless, few miners have yet made deep cuts in output and the trend is set to put more pressure on depressed prices.

"It's a staring contest, no one wants to be the first to take the pain," said Robin Bhar, an analyst at Societe Generale in London.

Three month nickel on the London Metal Exchange hit $13,205 a tonne on July 9, the lowest since May 2009 and down from nearly $19,000 in February. Nickel is the worst performer on the exchange so far this year, down nearly 20 percent.

"I think you're going to have to see writedowns and maybe some further closures," he added.

The market is in a glut with registered stocks in LME warehouses at a record high above 200,000 tonnes, while Macquarie Bank forecasts nickel supply will rise 4.1 percent 1.845 million tonnes this year.

But at many mine sites, nickel producers are chasing lower operating costs by producing more.

Canada's First Quantum Minerals Ltd mined a third more nickel in the June quarter, while Western Areas Ltd has just had a record fiscal year in 2012/13. Rather than curb output to reduce costs, senior management at the Australian firm will take 10-20 percent pay cuts.

Fellow Australian Mincor Resources NL also beat its guidance and is maintaining production over the next 12 months.

And despite being one of BHP Billiton's least profitable businesses, the world's third-biggest nickel division only saw a 2,000-tonne drop in quarterly production from the previous and year-ago quarters.

PINING HOPES ON INDONESIA

Cuts to output so far have been paltry and there has been limited appetite to buy nickel assets, with the market expected to be in a big surplus this year.

As China's manufacturing intensity slows, the nickel market has been doubly hit, with China's stainless steel factories also turning away from high purity metal to cut costs.

Instead they are feeding a cheaper alternative - nickel pig iron - typically formed from laterite ore which has low nickel content - into their furnaces.

Macquarie and Citi cut their nickel price outlooks for this year and next, by 7 and 14 percent for Macquarie, and by 15 and 22 percent for Citi. The banks expect prices to average around $15,200 this year with Citi forecasting prices at $16,375 next year and Macquarie $15,500 a tonne.

Citi has also cut its earnings forecasts for Norilsk Nickel , the world's largest nickel producer, and Canada's First Quantum Minerals Ltd .

Based on current LME prices and excluding nickel pig iron capacity, Barclays estimates close to 450,000 tonnes of mine production capacity is losing money with "significant-sized nickel mines in countries like Australia and Canada that ostensibly have been losing money for the past 18 months."

But for now Glencore Xstrata, Vale, First Quantum, China Metallurgical Corp, Sherritt International and Sumitomo Corp are among companies spending heavily to build new nickel mines and processing plants. So far, the nickel industry is pinning its hopes on a tougher stance by Indonesia to curb exports of raw materials from 2014, with Eramet Chief Executive Patrick Buffet calling on Indonesia's government to confirm it will implement the ban aimed at processing more laterite ore at home.

But analysts say that a blanket ban is unlikely because it will have too big a hit on Indonesia's revenue.

"Short of a now very low probability supply squeeze from Indonesia next year, (we) have little reason to believe prices will recover in the next few years," Barclays said.

China relaxes futures grip as steelmakers test swaps market

By Ruby Lian and Fayen Wong

SHANGHAI, Aug 2 (Reuters) - Chinese state-owned steelmakers are preparing to enter the Singapore-based iron ore swaps market, in a move that could boost liquidity in iron ore derivatives as firms look to hedge volatile prices.

The step is another in the evolution of iron ore trading, where benchmark prices were set by annual talks just four years ago, and a further sign Beijing is relaxing its tight grip on trading offshore commodities futures contracts. Baosteel , China's third-largest steelmaker by output, and Valin, the listed unit of the tenth-biggest steelmaker Hunan Valin Group, have both won approval to trade iron ore futures overseas, company officials confirmed.

"There have always been arguments over whether steel mills should trade futures for hedging or not," said Wang Jun, vice president of state-owned Hunan Valin Steel Co .

"We don't want the market to become overly speculative, but when the trend is happening, we might have to face it and do it," he said.

Chinese privately owned steelmakers and iron ore traders have already been increasing their use of iron ore derivatives this year, accounting for up to a third of the volume on the Singapore Exchange's swap contracts in some months, brokers said.

MARKET NEWS *(Continued)*

Liqudity jumped rapidly to 136 million tonnes in the first half of 2013, traders estimate, compared with 110 million tonnes in all of 2012, but is still dwarfed by the 1.1 billion tonnes of physical seaborne iron ore traded each year.

The Singapore Exchange cleared more than 27 million tonnes of iron ore derivatives in July, hitting a record high and more than double the 10.4 million tonnes in July 2012, data showed.

The popularity of swap contracts has been boosted by a move in 2010 to price iron ore based on indices like the Steel Index or the Metal Bulletin Iron Ore Index, which has increased price volatility.

China consumes more than two-thirds of physical seaborne iron ore, while prices have swung from above $190 a tonne in early 2011 to below $90 a tonne in September last year.

"More and more Chinese companies want to trade futures to manage their risks," said Han Xun, The Steel Index's China manager in Shanghai.

China's Minmetals Corp, a leading state-owned resources trader, has started trading iron ore swaps. Other privately owned mills that trade the paper include Rizhao Steel Holding Group, Jiangxi PXSteel Industrial Co and the largest private firm, Jiangsu Shagang Group, brokers said.

CONTROLS EASED

Beijing has kept a tight rein on overseas derivatives trading by state-owned firms, particularly after they lost a combined tens of billions of yuan by trading offshore futures during the global financial crisis.

Previously, only 31 state-owned Chinese firms were allowed to trade futures overseas, mainly for base metals, agriculture products and oil, industry sources said.

Some state-owned enterprises (SOEs) had used their offshore units to trade derivatives, circumventing supervision and currency controls, they said.

"The government has actually eased its control on SOEs in doing paper now, and firms can get approval easier than before," a senior official at Baosteel said, declining to be named as he was not authorised to speak to media.

While the state-owned steelmakers are preparing to dip a toe in swaps trading, their participation is unlikely to lead to an immediate boost in liquidity due to China's tight regulations on currency conversion.

They also face quotas on how much they can trade and restrictions on how they can trade, said The Steel Index's Han.

The companies themselves are worried about a lack of experience in the market, and the fallout from any losses.

Valin, which produced about 16 million tonnes of crude steel last year, said it plans to hedge no more than one tenth of the total iron ore volume that it consumes a year.

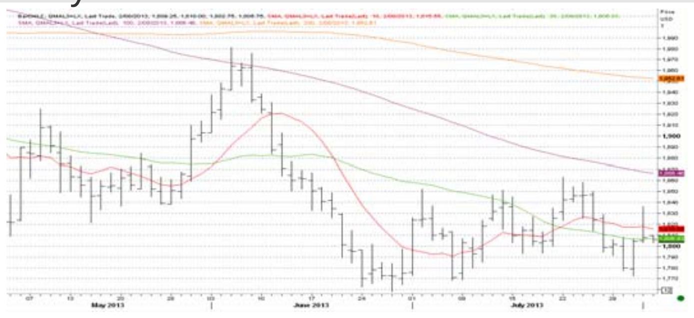
"We are still grooming our team and are currently doing trials," Valin's Wang said, without disclosing its quota and annual consumption.

However, the lessons learned will help the companies when the China Dalian Commodity Exchange launches its own iron ore futures contract later this year, which is expected to draw heavy interest from local steel mills and iron ore traders, traders said.

Dalian will rival the Singapore Exchange, which dominates the iron ore paper market by clearing more than 90 percent of swap volumes, and the CME Group's iron ore futures.

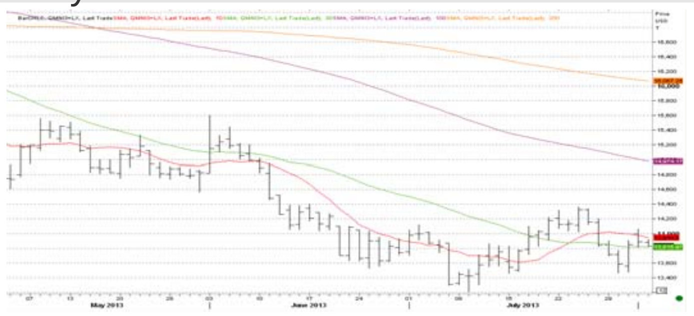
ANALYTIC CHARTS *(Click on the charts for full-size image)*

Daily LME Aluminium 3-months



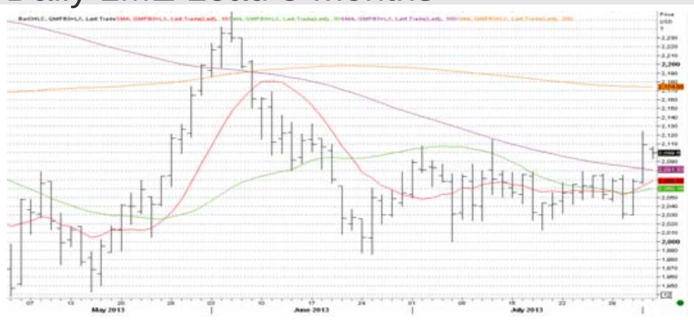
Daily LME Copper 3-months

Daily LME Nickel 3-months



Daily LME Zinc 3-months

Daily LME Lead 3-months



Daily LME Tin 3-months

Daily LME Alloy 3-months

Daily LME Nasaac 3-months

MARKET REVIEW

METALS-Copper eyes weekly gain after factories pick up

By Melanie Burton

SINGAPORE, Aug 2 (Reuters) - London copper edged down on profit taking, but was heading for the first weekly gain in three, supported by signs of stabilisation in global factory sector growth and the accommodative stance of top central banks.

Factory activity in China, the world's top metals consumer, was slightly stronger than expected in July, while U.S. manufacturing grew at the fastest clip in two years and European factories snapped a run of declining output, offering tentative support for metals demand.

Still, analysts cautioned against rushing to a conclusion that the world's second-largest economy had arrested its slowdown.

"Our Chinese economists have highlighted that order books are still pretty slow and the smaller-sized businesses are still struggling with tight credit conditions," said analyst Natalie Rampono of ANZ in Melbourne.

"Firmer prices are probably due more to a short-covering rally than a change in the fundamental attitude towards China," she added.

Three-month copper on the London Metal Exchange slipped by 0.45 percent to $6,966.25 a tonne by 0233 GMT, eroding gains of 1.7 percent from the previous session.

Prices are set to close the week up by more than 1.5 percent, the second-biggest gain since early May.

The most-traded November copper contract on the Shanghai Futures Exchange climbed by 0.46 percent to 50,070 yuan ($8,200) a tonne.

Metals have been underpinned after U.S. monetary officials this week made no mention of scaling back bond buying and as the European Central Bank affirmed interest rates could fall further from record lows.

Markets are now awaiting July U.S. jobs figures for further signs of stabilisation in the U.S. economy.

"If the non farm payrolls surprises on the upside, we could see a further pick-up in copper prices but I think gains might be limited," ANZ's Rampono added.

High aluminium premiums may not fall despite Goldman Sachs' olive branch to beleaguered metals customers, but even critics praised the proposal as a smart move to placate regulators and silence complaints.

PRECIOUS-Gold heads for biggest weekly loss in a month

By A. Ananthalakshmi

SINGAPORE, Aug 2 (Reuters) - Gold fell for a fifth session heading for its biggest weekly loss in a month as strong U.S. economic data raised fears the Federal Reserve may start to taper its commodities-supportive stimulus measures.

Positive jobless benefits and factory activity data followed stronger-than-expected U.S. GDP numbers this week. The Fed has said its policy remains driven by data, even though it gave no signs in a statement on Wednesday that it was set to wind down its $85 billion monthly bond-buying measures.

"We are still expecting the Fed to taper its QE in September," said Barnabas Gan, an analyst at OCBC Bank, referring to quantitative easing.

"The labour data, along with GDP, is pretty positive and allows for the Fed to taper this year."

Spot gold fell 0.1 percent to $1,306.15 an ounce by 0333 GMT, bringing losses this week to 2 percent.

U.S. gold slipped about $6 to $1,305.70.

Gold traders are now waiting for U.S. nonfarm payrolls data due later on Friday.

U.S. employers likely hired enough workers in July to push the jobless rate to near its lowest level in more than four years and bring the Fed within months of paring back its stimulus program, economists polled by Reuters said.

"If the report is bullish, gold prices will continue to see downward pressure," said Gan, who expects gold prices to fall to $1,250 by the end of the year.

Spot gold is expected to drop to $1,284 per ounce, as it has broken a support at $1,308, Reuters technicals analyst Wang Tao said.

Holdings in SPDR Gold Trust , the world's largest gold-backed exchange-traded fund, fell 0.7 percent to 921.05 tonnes on Thursday, hitting fresh four year lows.

Outflows from the top eight gold ETFs tracked by Reuters have totalled 19 million ounces so far this year, or about $25 billion at current prices.

Physical demand, however, has held up reasonably well despite the volatility in prices.

Premiums over London spot prices, one of the best measures of physical demand, were about $23 an ounce in China, which is set to overtake India as the top gold consumer this year.

FOREX-Dollar holds steady, focus on U.S. jobs data

By Masayuki Kitano

SINGAPORE, Aug 2 (Reuters) - The dollar held steady versus the yen on Friday, clinging to hefty gains made the previous day after better-than-expected U.S. data stirred hopes for an upbeat nonfarm payrolls report.

The dollar was little changed on the day at 99.56 yen after having surged about 1.7 percent on Thursday, the greenback's biggest one-day percentage rise against the yen in about four months.

MARKET REVIEW *(Continued)*

U.S. data on jobless claims and manufacturing that showed the world's largest economy was recovering steadily had fuelled Thursday's rally in the dollar.

Investors are now looking forward to nonfarm payrolls data, to be released later on Friday, with greater expectations that July will show a solid rise, which could increase the likelihood that the Federal Reserve will start scaling back its monetary stimulus later this year.

A Reuters survey of economists pointed to an increase of 184,000 in nonfarm payrolls. The jobless rate is seen dropping to 7.5 percent from 7.6 percent.

With expectations already running high, however, analysts said the dollar could slide if the jobs data were to disappoint.

"I think you have to be careful this time," said Daisuke Karakama, market economist for Mizuho Bank in Tokyo. "There was talk in the market yesterday that the number could be about 205,000 or 210,000, so I get the sense that these types of numbers have already been factored in."

The dollar index, which measures the greenback's value against a basket of currencies, held steady at 82.363, having bounced from a six-week low of 81.407 set on Wednesday.

The Fed's post-meeting statement on Wednesday had offered no fresh hints that the U.S. central bank was preparing to reduce its monetary stimulus at its next policy meeting in September, and market players are looking to U.S. economic data for clues on when such tapering might start.

Short-term market positioning is probably tilted toward being long the dollar, said Satoshi Okagawa, senior global markets analyst for Sumitomo Mitsui Banking Corporation in Singapore.

"If we get a bad number the dollar might fall sharply," he said.

Still, the greenback will probably head higher over the longer term since the Fed seems to be moving in the direction of monetary tightening, even if the timing of any interest rate hike is still far off, Okagawa said.

"I think we will see some back and forth moves. But when you take a look back at some point, you'll end up realising that the dollar has risen quite a bit," he added.

The euro held steady at $1.3209 , having retreated from a six-week high of $1.3345 set on Wednesday.

The euro had come under pressure on Thursday after the European Central Bank left interest rates at a record low 0.5 percent and affirmed that they will remain there for some while to come and could yet fall further.

The Australian dollar, already on the back foot, dipped to a fresh three-year low of $0.8889 before recovering a bit to last stand at $0.8910. It was on track to end the week down around 3.9 percent.

Analysts in a Reuters poll conducted this week were unanimous in expecting a quarter point rate cut at Tuesday's Reserve Bank of Australia policy meeting.

Slower growth in China, Australia's top export market, a domestic economy that is growing below potential and a tame inflation outlook mean the RBA has room to lower its cash rate to a record low 2.5 percent.

(Inside Metals is compiled by Pradip Kakoti in Bangalore)