

Investment banks are having to adapt as the commodities environment changes in the Asia-Pacific region. Managing Director and Chief Executive Officer of the Global Commodities Group for Asia-Pacific, Ray Eyles, explains how JP Morgan is expanding its presence in the region and remaining at the forefront of product developments

JP MORGAN JUMPS ON ASIA POTENTIAL

The acquisition of select assets from Royal Bank of Scotland (RBS) Sempra Commodities has boosted JP Morgan's global presence. How will your business in the Asia-Pacific benefit from the merger?

Ray Eyles (RE), Managing Director and Chief Executive Officer of the Global Commodities Group Asia-Pacific, JP Morgan: This has been a very complementary addition to JP Morgan's platform, strengthening our product capabilities across physical oil and physical base metals – including global warehousing capabilities. Specifically in Asia-Pacific last year, JP Morgan successfully integrated physical trading and origination teams across Singapore, China, Korea and Japan. It now has unprecedented access to both warrant and non-warrant forms of base metals. The presence of the Henry Bath Group gives us strategic access to warehousing and logistics that enables the effective storage and shipping of ferrous and non-ferrous metals in the region.

On the oil side, JP Morgan now has physical capabilities across the full product range of crude, refinery feedstocks and refined products covering many parts of the downstream value chain – storage, transportation and blending. The merger has also increased the number of clients the

firm serves or trades by about 70% in the region. I believe it is essential that we now have 'physical' in our 'DNA' more than ever before and this would have been very hard to achieve organically.

What is JP Morgan's strategy in the medium term for its commodities business in the Asia-Pacific region?

RE: We will focus on the execution of the well-balanced product suite that caters to our client needs – flow derivatives, strategic hedging (event-driven hedge programmes) and commodity-linked financing transactions, including inventory financing, energy supply and off-take. That positions us as one of the most highly diversified commodities risk management platforms in Asia-Pacific. Over the past two years, in addition to the integration of the heritage RBS Sempra Commodities businesses, we have developed capabilities in regional agricultural commodities, power and physical coal. We have also established a presence onshore in China and Korea, and set up a gold vault in Singapore.

JP Morgan has a strong regional franchise across cross-selling generalists, debt capital markets, trade finance and natural resource investment banking. We are also

growing the corporate banking business, which has deep roots in the natural resource space in the region. It is the ability to dovetail financing with our physical trading and financial risk management capabilities, as well as leverage the firm's broader franchise, that is a key priority of mine.

How do you think the commodities environment has changed in the past decade – in terms of both supply and demand? Is China the biggest consumer of almost every commodity or is it hungrier for some more than others?

RE: Demand has shifted east to Asia. Supply is moving this way as well – but at a slower pace – especially as Asia is not self sufficient in a number of key consuming commodities. For agriculture, capacity utilisation is high as a result of Asian demand growth. High prices are required to maintain capacity increases. More importantly, the consistently strong demand allows the industry little buffer room in the case of production disappointments globally. In metals, Asia is dominating the capacity build-out in refining and smelting, but remains significantly short of feedstock.

In metals, China is the dominant consumer in every category, accounting for 35–50% of global consumption

and more than 75% of global consumption growth. The pattern of consumption in China started with a concentration on the commodities most leveraged to infrastructure and production (industrial metals), but is now increasing in commodities leveraged to the development of a consuming middle class (for example, meats, dairy and sugar). In agriculture and energy, China is less dominant than it is with metals, which reflects China's development phase. As the middle class expands further and becomes wealthier, we can expect to see significant increases in the consumption of foodstuffs and energies, and less in crude steel and cement.

What are your views on the development of regional commodity exchanges and their impact on expanding liquidity in the Asia time zone?

RE: Several new exchanges have sprouted recently, such as the Singapore Mercantile Exchange and the Hong Kong Mercantile Exchange, with reasonably low liquidity thus far – some contracts are lookalikes to Western contracts. Only time will tell whether these will be successful in the long run vis-à-vis the more established Western exchanges. The London Metal Exchange (LME) and Singapore Exchange tie-up for mini LME contracts in the Asia time zone seems to have had good traction at the recent launch.

Chinese commodity exchanges volumes continue to skyrocket, if you look at Shanghai and Dalian's volumes/turnover. China has increased its share of global turnover in base metals and agricultural commodities. For example, the zinc, sugar, cotton, soybean meal and bean oil that traded on Chinese exchanges exceeded the turnover of their global exchange equivalents. The long-term trajectory of China's commodity exchanges will be dependent on the full convertibility of the Chinese yuan. This will have a bigger impact on volumes as more offshore investors gain access to



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onshore products – but that is likely to take some time. However, it is undeniable that China's commodities exchanges will continue to have a very meaningful influence on pricing globally.

How have commodities as an asset class caught on with institutional investors in the region and what are some of the challenges that banks face? How is JP Morgan adapting to these challenges?

RE: Institutional investors have taken renewed interest in the commodity sector for several reasons – the threat of inflation is a major concern for portfolio managers in the region; and the weakening correlation between the commodity sector and the equities markets has dominated markets post-crisis as a trend of general risk aversion. The benefits of diversification are, once again, an important discussion point for investors in Asia. It is important that the recent moves in commodity

prices – coming from well-publicised events such as weather, natural disasters and political instability – have brought the asset class to the forefront of investors' minds.

Although institutional investors in Asia were, arguably, latecomers to this asset class – relative to those in Europe and the US – they have recently entered at the more sophisticated end of the spectrum, utilising both enhanced beta approaches as well as absolute return alpha strategies. Investors have been demanding more flexible and dynamic strategies to ensure their investments respond positively to shifting trends and cyclical moves.

JP Morgan has been proactively serving investors – it has built a gold vault in Singapore, now fully operational. The building of this facility was based on the strong regional desire – both at a private and institutional level – to diversify the location of its growing gold holdings, and on the strong logistical fit between regional production and consumption. The facility will also accommodate the trading of physically settled futures contracts on regional exchanges, regional exchange traded fund allocations, as well as physically settled gold transactions within which JP Morgan is continuously involved.

The challenge for us as an investment bank is to ensure we remain firmly at the leading edge of these product developments, and work with our clients on an ongoing basis to ensure their investment objectives are constantly met, and their commodity investments and natural resource exposures are effectively functioning as portfolio management solutions.

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