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Metal Matters February 2018

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GLOBAL BANKING AND MARKETS

The precious metals' prices are consolidating after strong performances since mid-December. Given a high opportunity cost of holding precious metals, the overall price strength suggests bullish sentiment is strong.

- Gold prices have rallied 10.5% from the December lows and prices are now challenging key resistance on the chart around $1,366/oz – clearance could signal an upside break.

- Dollar weakness has helped fuel the rally in Gold prices, but Gold has managed to battle through the headwinds from record-setting equities and a tighter monetary policy outlook.

- We expect Gold is being bought as insurance against a rise in geopolitical tensions, or against a correction in broader markets.

- Funds have been buying Gold, while the short interest remains low. The ratio of longs to shorts is 3.4 to1.

- The Gold chart continues to look bullish with prices well placed to break out of a multi-year base.

Silver's rebound has been stronger than Gold's, but the Gold/Silver ratio is still high, meaning Silver prices could outpace Gold's in percentage terms.

- ETF and fund interest in Silver is subdued – if prices do rally further then a pick-up in investor interest could provide fuel.

Palladium prices set all-time highs in January, but prices are now consolidating – we expect dips to be well supported. Sentiment seems to have turned bullish for Platinum and there is plenty of upside potential.

- The structure deficit in Palladium may mean demand destruction could be needed, but that spells higher prices.

Gold prices consolidate after strong gains – key resistance lies overhead

Gold's price rally following the December Federal Open Market Committee (FOMC) meeting has been surprisingly strong, with prices rising to a high of $1,366.15/oz on 25th January, which surpassed the previous high of $1,357.55/oz from September 2017 and which now puts the 2016 high of $1,375.25/oz within range. Considering the tightening monetary policy in the US, rising US Treasury bond yields and record-setting equity markets, Gold prices have done well to climb and even better to forge ahead. That said, they have had support from a weakening dollar, which has seen the dollar index fall to 88.43 from around 94 at the time of the December FOMC meeting.

Limited downside on the dollar

The dollar's weakness seems to be driven by a combination of the market having already discounted US interest rate rises, whilst now expecting the ECB to tighten monetary policy. While it may be the case that the ECB reduces its monthly asset purchases in the months ahead, the fact ECB President Mario Draghi recently made it clear that he does not expect ECB interest rates to rise this year suggests the dollar should not weaken too much further against the euro. This is especially so as the current expectation is for three US interest rate rises this year. In addition, with US ten-year treasuries yielding 2.7 percent and German ten-year bunds yielding 0.67 percent, money is likely to flow towards the US. A rebound in the dollar would likely prove a strong headwind for Gold prices, unless other bullish factors unfold – we think they may.

Commodities are back in vogue

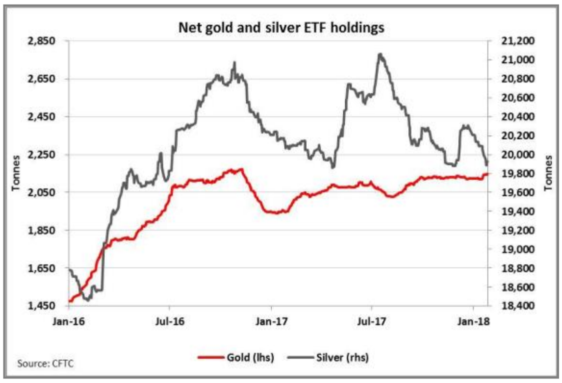
There are similarities between now and the early 2000s as we are emerging from a period of ultra-loose monetary policy; in the early 2000s monetary policy was loose following the dot.com bubble and the 9/11 terrorist attacks. The driving force in the early 2000s was the start of the super-cycle, which was focused on China. Today we are seeing more signs of concerted global growth, led by strong recoveries in the US and Europe, with emerging markets and China recovering too. We also have the electric vehicle (EV) revolution unfolding at a fast pace. All these are likely to be bullish for industrial metals and oil, and a more affluent global economy may lead to a pick-up in jewellery sales. More to the point, the combination of rising metal demand and constrained metal production following reduced capital expenditure by producers in the downturn (2012-2015) is likely to lead to strong commodity prices, which in turn is likely to lead to a pick-up in investor interest in commodity baskets – which were a strong driving force in the mid-2000s.

Gold also acts as an insurance

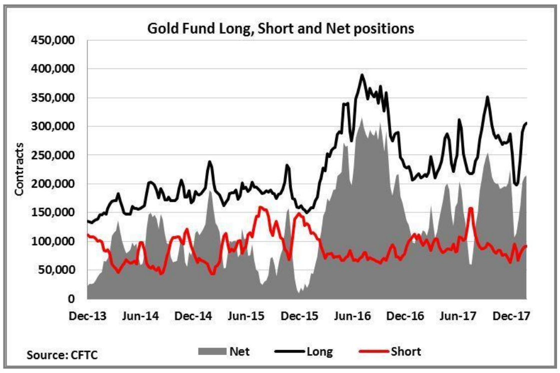
Having Gold as part of a commodity basket also makes sense as it offers a degree of insurance should either the broader market suffer a correction, or geopolitical issues escalate. Record-setting global equities may well start to wobble if inflation starts to pick up, or if bond yields/interest rates continue to rise. Some bond pundits think the tipping point is when US ten-year treasury yields hit 3 percent; with yields now at 2.72 percent, a correction may not be too far away. Likewise, a correction could unfold if geopolitical tensions rise. While geopolitical tensions have currently eased, it seems unlikely that the US and Japan will allow North Korea to continue to threaten their nations, while changes in Saudi Arabia and protests in Iran may lead to greater tension in this all-important oil region.

LBMA 2018 forecasts

The LBMA organizes an annual forecast survey – for 2018, the 24 analysts' average forecast for Gold is $1,318/oz, with the forecasts ranged between $1,215/oz and $1,381/oz. The main factor determining whether analysts are bullish or bearish seems to be their view on the dollar and US interest rates.



ETF holdings edge higher in January
Longer-term investors are accumulating Gold through ETFs, but their buying is fairly subdued. Holdings climbed 25 tonnes in January to 2,147 tonnes, the highest since November 2016. The lowest holdings have been since then is 1,939 tonnes, which was seen in January 2017, the all-time high being 2,647 tonnes in January 2013.



Funds have been buyers for six weeks
While ETF investors may have only been light buyers, the funds trading Comex have been more aggressive with the net long fund position (NLFP) climbing to 214,684 contracts from 135,948 contracts at the end of 2017 and a recent low of 107,068 contracts on 12th December 2017. The rise has predominantly been driven by fresh buying, the longs having increased their position by 103,900 contracts over the same period, while shorts have cut their holdings by 3,716 contracts.

Physical demand – While rising Gold prices may have deterred physical demand, we expect retail demand for jewellery and coins/bars to recover this year. We think there is considerable pent-up demand in India, following a few years of government policy changes, but as the market gets used to the new system then demand is likely to return. Any cut in import duty, which is expected, should also help boost demand, especially if jewellery manufacturers have been holding back waiting for such a cut. Likewise, more concerted global economic growth is expected to lead to a recovery in retail demand for Gold.

Technical – This weekly chart of Gold prices shows a potential large 'W'-shaped base formation with prices challenging the resistance line ($1,366/oz) that runs along the top of the pattern. The stochastics are already looking strong, suggesting good buying interest. Each move above $1,366/oz, $1,375/oz and $1,388/oz would be a step further towards breaking higher.

Summary – Gold prices have done well to climb as much as they have; the weaker dollar is no doubt helping, but the persistent strength suggests bullish sentiment is strong. As we said in the January Metal Matters report, we think commodities are in vogue with investors and Gold offers portfolio insurance. Although the chart looks potentially overbought, it is also looking bullish.

Gold Statistics	2014	2015	2016	2017	Q3 2017	Q4 2017	Dec-17	Jan-18
London Prices (US$/oz)								
AM fix	1266.34	1162.49	1248.16	1257.85	1277.96	1276.51	1265.67	1332.81
Pm fix	1266.20	1161.30	1248.34	1257.13	1277.84	1274.35	1261.26	1331.67
Average	1266.27	1161.89	1248.25	1257.49	1277.90	1275.43	1263.47	1332.24
Parity prices								
Australian - A$/oz	1,403	1,544	1678.88	1645.14	1,637	1,659	1,652	1,676
South Africa Rand/kg	440,562	474,410	589,051	537,559	540,737	558,876	532,578	521,928
Japan Y/g	4,146	4,355	4,203	4,370	4,393	4,463	4,422	4,581
India Rupee/oz	77,077	74,310	83,721	81,767	82,069	82,499	80,984	84,600
COMEX - futures contracts								
Stocks ('000oz)	8,203	7,422	8,962	8,860	8,707	8,970	9,234	9,258
Vol (million contracts)	40.52	41.76	51.84	72.80	19.95	20.47	5.19	~
OI ('000 contracts)	380	418	550.71	479.85	512	511	545	554
CFTC (futures only data)								
Net Spec position Long (Short)	98,265	88,022	201,250	163,493	178,157	166,887	135,948	214,684
TOCOM								
Stocks ('000oz)	146	127	120	73	67	60	68	~
Volume ('000 contracts)	8,744	7,928	8,540	5,750	1,233	1,524	551	~
OI ('000 contracts)	88	94	88	87	92	98	87	91
Other Indicators								
FT Au Mines Index	1,409	1,061	1,579	1,521	1,566	1,472	1,560	1,576
Dow Jones Index	16,837	17,524	18,062	21,990	22,096	24,113	24,698	26,149
US$ Index	83.0	96.7	97.1	96.0	92.9	93.3	92.3	89.1
Gold Bullion Imports, tonnes (exports)								
Dubai	136	118	~					
China	1297	1610	1,281					
India	776	949	582					
Italy	103	~	~					
Japan	-80	-107	~					
Singapore	284	~	~					
South Korea	24	~	~					
Taiwan	22	30	28					
Turkey	102	49	106					

Data: Financial Times; Bombay Bullion Association; LBMA; TOCOM; COMEX; CFTC, REUTERS
Figures are period averages unless marked by *, indicating the period end. OI= Open Interest on the exchange
~ = data not available yet, *italics* = estimates

Silver prices recover after spiking lower ahead of December's FOMC meeting

Silver prices have rallied 13.3 percent to $17.703/oz in January, up from a low of $15.623/oz on 12th December. This compares with a 10.5 percent rally in Gold prices over the same period. The Gold/Silver ratio at 77.80 remains elevated, which implies Silver is generally underperforming Gold (the performance so far this year may be signalling that is changing). After an initial strong rally in Silver in early 2016, when metal prices started to turn higher – seeing the ratio drop to 64 – the ratio has since trended higher to a high around 79.50. With other industrial metals putting in strong performances in recent months and with commodities seeming to be in vogue with investors, we would not be surprised to see Silver prices outperform Gold in terms of percentage gains.

Concerted global growth bodes well

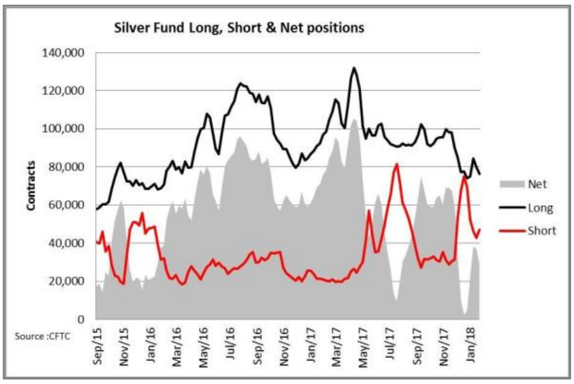
Silver, as an industrial metal, is expected to benefit from greater concerted global growth. In addition, with the electric vehicles (EV) revolution gaining momentum, there will be greater need for more energy generation to support bigger EV populations. India's and China's Silver imports were up by 60 percent and 30 percent respectively in 2017, which may well highlight the pick-up in production of solar projects. Both countries have ambitious alternative energy plans, with China's solar energy still only producing one percent of total energy demand.

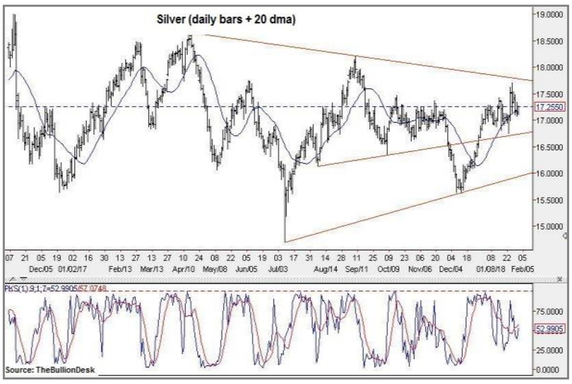
ETF investor interest in decline

ETF holdings stood at 19,892 tonnes in late January, down from 20,209 tonnes at the start of the year and from a peak in July 2017 of 21,062 tonnes.

Fund interest remains subdued

The funds trading Comex Silver have been reducing exposure, with the gross long fund position at 76,193 contracts on 23rd January, this compared with a range of 74,013 to 131,969 contracts in 2017. The gross short position at 47,112 contracts is more mid-range, with the 2017 range being 19,797 to 81,400 contracts. As the chart shows, the run up in the gross short position (spike up in the red line) has now largely been closed out, but the downward trending gross long position implies bullish interest is waning.





Technical – Silver prices bounced back constructively from the December sell-off and prices have cleared considerable supply on the chart from the band of trading seen in October and November last year. Prices were, however, turned back ahead of the resistance line and for now trading in the upper triangle looks likely to continue.

Summary – We are bullish for Silver prices as we expect concerted global growth to boost demand for industrial commodities. Likewise, as we are bullish for Gold we expect Silver prices to benefit from stronger Gold prices. Indeed, industrial demand and safe haven demand could see Silver prices rise at a faster pace than Gold prices.

Silver Statistics	2014	2015	2016	2017	Q3 2017	Q4 2017	Dec-17	Jan-18
London Prices (US$/oz)								
Daily Fix	19.08	15.71	17.10	17.05	16.83	16.70	16.16	17.17
Parity (London) prices								
Japan (Y/g)	70.31	58.92	57.46	59.27	57.87	58.44	56.56	59.03
India (Rupee/oz)	1,312.5	1,004.7	1,147.5	1,109.5	1,081.2	1,080.4	1,035.9	1,090.2
COMEX – futures contracts								
Stocks (Moz)*	178.9	171.6	162.1	210.8	216.5	237.4	245.5	247.0
Vol (million contracts)	13.7	13.5	17.0	23.0	6.2	5.8	1.4	~
OI (‘000 contracts)*	155.8	169.6	188.8	191.6	192.3	169.9	195.1	198.2
CFTC (Futures Only Data) non-commercial								
Net Positions *	19,307	31,269	69,366	56,301	44,441	33,731	4,648	29,081
TOCOM								
Stocks (Moz)*	0.2	0.16	0.16	0.18	0.16	0.11	0.13	~
Futures Vol (‘000 contracts)	86.1	62.6	61.1	20.6	3.8	4.5	2.7	~
Futures OI (‘000 contracts)*	4.5	3.1	3.3	1.8	1.8	1.6	1.4	1.4
Other Indicators								
Gold/Silver ratio*	67.6	74.4	73.0	74.3	75.8	76.8	76.8	77.7
Silver Bullion Imports (tonnes)								
USA	3835	5464	5956					
Japan	1688	1560	1833					
India	5819	7954	2793					
Italy	796	843	675					
Hong Kong	948	839	659					
China (exports)	1369	2054	-137					

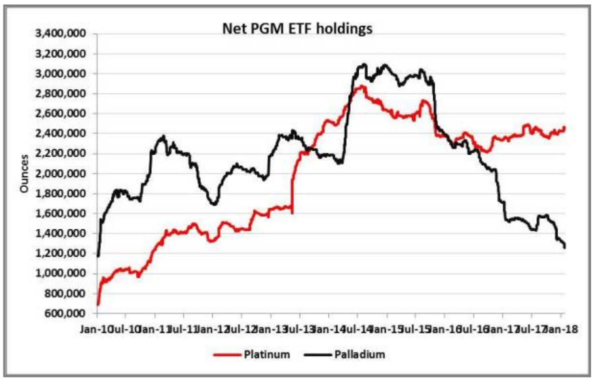
* figures are period averages unless marked; ~ not available yet, *italics* = estimate.

Platinum starts to show independent strength, while Palladium consolidates

Palladium's price extended in early January to set an all-time high of $1,140/oz on 15th January, overcoming the former high at $1,110/oz from January 2001 in the process. Prices have since started to correct quite sharply, recently being quoted at $1,030/oz. Platinum prices have rallied strongly, rising 17.9 percent to a high of $1,029.50/oz on 25th January, up from December's low of $873/oz. Platinum's rally outperformed that of Gold as Gold prices rallied 10.5% over the same period.

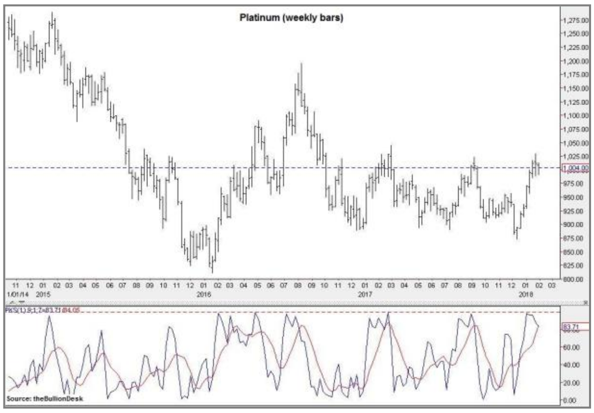
Platinum has catch-up potential

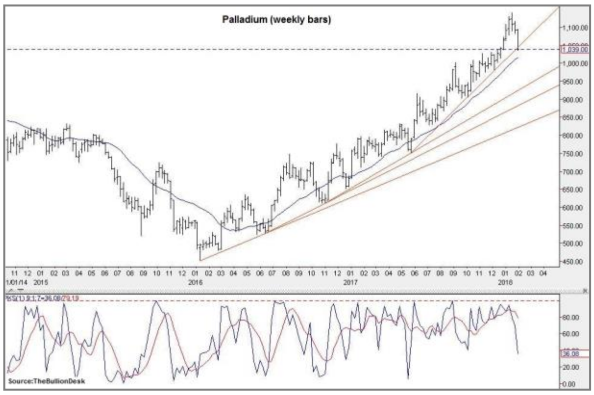
With Palladium prices rallying from strength to strength and with the market facing continuing tight fundamentals, we expect autocatalyst manufacturers to start looking at using more Platinum to reduce their dependence on Palladium for petrol vehicles. Although it is likely to take time before new autocatalysts are used, auto manufacturers may well secure their PGM requirements up front. In addition, with global growth picking up and with precious metals prices trending higher, we expect demand for jewellery to recover after some weak years, and Platinum's price discount to Gold may well channel jewellery demand into Platinum.



ETF Palladium redemptions feed deficit

The rally in Palladium prices is prompting investors to take profits and in doing so they are providing much needed supply to the physical market that is suffering from the supply deficit. ETF holdings stand at 1.247 million ounces (Moz) on 29th January, down from 1.330 Moz at the end of 2017. At the peak in 2014, holdings stood at 3.094 Moz. Given the bullish outlook, it is not inconceivable that investors start buying Palladium again – that would reduce supply and increase demand, which could have a significant bullish impact on prices. In the LBMA Forecast Survey, the average of the analysts' forecasts was $1,080/oz. Holdings in the Platinum ETFs have been climbing; they were 2.451 Moz on 29th January, up from 2.426 Moz at the end of 2017. Funds trading Platinum on Nymex are bullish with longs buying and shorts covering; the net long fund position (NLFP) has climbed to 42,916 contracts from a low of 12,824 contracts on 12th December. In Palladium, the NLFP has been fairly flat so far in 2018 – at 26,663 contracts, it is up from last year's average of 20,365 contracts.





Technical & Summary - The strong rebound in Platinum prices suggests sentiment has changed so we expect prices to continue to recover. Palladium prices are correcting, we expect the dip to be well supported and for prices to still work higher as the fundamentals look set to remain tight. Demand destruction via higher prices may be needed to balance the Palladium market.

PGM Statistics	2014	2015	2016	2017	Q3 2017	Q4 2017	Dec-17	Jan-18
London Prices (US$/oz)								
Platinum	1,390	1,060	976	949	953	921	907	988
Palladium	809	692	611	869	901	992	1,021	1,095
Rhodium	1,180	953	694	1,101	1,077	1,477	1,597	1,706
Japanese Parity Prices (Y/g)								
Platinum	4,519	3,965	3,278	3,298	3,275	3,221	3,176	3,396
Palladium	2,636	2,587	2,050	3,020	3,097	3,472	3,572	3,765.77
South African Parity Prices (Rand/kg)								
Platinum	466,074	417,839	444,891	391,696	388,728	389,038	368,816	373,134
NYMEX Stocks ('000oz)								
Platinum	195.8	138.8	205.1	215.0	214.0	194.6	193.0	178.8
Palladium	347.4	134.0	71.1	50.2	47.0	49.6	40.7	40.7
CFTC Futures Only Data Long / (short) non-commercial								
Platinum	35,840	24,585	31,817	24,302	23,972	21,430	16,313	42,916
Palladium	22,276	12,080	8,765	20,660	21,134	23,565	25,498	26,663
Tocom - Platinum								
Stocks ('000oz)	46.6	53.8	57.1	47.1	46.1	54.2	56.3	~
Vol (Million contracts)	4.6	3.9	2.9	2.5	0.4	0.6	0.2	~
OI ('000 contracts)	72.6	69.7	52.7	56.8	60.2	55.0	51.6	45.3
Tocom - Palladium								
Stocks ('000oz)	3.2	5.4	11.1	3.6	3.1	1.0	0.9	~
Vol ('000 contracts)	77	63	30	32	5.5	9.3	3.1	~
OI ('000 contracts)	2.0	1.8	1.1	1.4	1.6	1.4	1.3	1.3
Other Indicators (US$/oz)								
Pt-Au spread	115	-100	-253	-320	-341	-355	-356	-343
Pt-Pd spread	568	245	369	59	30	-77	-77	-29
Platinum Bullion imports (kg)	2014	2015	2016			2017		
USA	141,413	238,740	201,412			401,756	(Jan-Oct)	
Japan	32,684	47,283	44,786			42,986	(Jan-Dec)	
PalladiumBullion imports (kg)	2014	2015	2016					
USA	92,400	82,500	88,800			63,360	(Jan-Oct)	
Japan	58,429	57,223	58,860			59,492	(Jan-Dec)	

~ = data not available yet, *italics* = estimates

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