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GLOBAL BANKING AND MARKETS

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Metal Matters

June 2018

Gold prices have been under pressure on the back of rising US treasury yields and a strong dollar; safe-haven buying has been limited.

- The US 10-year treasury yield held above 3 percent for an extended period and the dollar index climbed to levels not seen since November 2017. These factors have increased the opportunity cost of holding Gold.
- Gold did not attract much safe-haven buying when the US pulled out of the Iran Nuclear deal and it barely budged when concerns escalated over Italy's political impasse.
- Investors now have a conundrum – do rising bond yields offer an opportunity, or will they prompt a broad market correction, one where Gold would offer a safe-haven?
- Gold prices may spend longer consolidating as investors wait for more direction from financial markets and geopolitics.

Silver prices held up better than Gold prices in May; this could unnerve funds, which have a large short position.

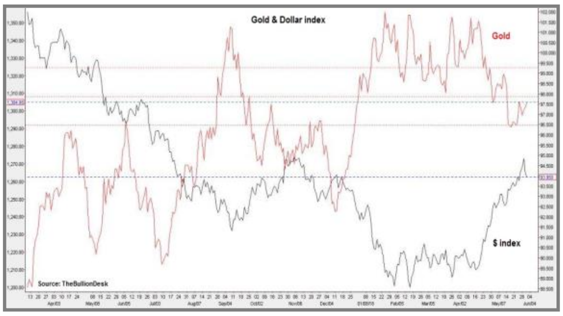
- Industrial demand is subdued, and consumers seem in no hurry to restock – this might change if economic data improves.

Platinum prices followed Gold prices lower, but they have since rebounded off the low, while Palladium prices have been consolidating.

- The funds' Platinum position could switch net short, but the large short position raises the risk of a short-covering rally.

Gold prices driven by opportunity cost factors more so than safe-haven matters

May was a month of two halves for Gold, with spot prices continuing to trend lower in the first part of the month before rebounding later in the month. The rise in US treasury yields that saw the 10-year treasury yield climb to 3.128 percent on 17th May, kept downward pressure on Gold prices that set a low of $1,282.15/oz on May 21. The pullback in Gold prices during this period happened despite a pick-up in geopolitical tensions, which included US President Donald Trump pulling out of the Iran nuclear deal. It was not until the rally in US treasury yields halted and started to retreat that bargain hunting came back into Gold. That said, Gold prices did jump on the back of Trump's announcement that he had cancelled the US/North Korea Summit, but the move was short-lived. Prices also hardly responded to the political crisis in Italy, when Italy's president, Sergio Mattarella, initially prevented the coalition parties from forming a government. This could have meant new elections, which would run the risk of reopening the 2011/2012 EU crisis.

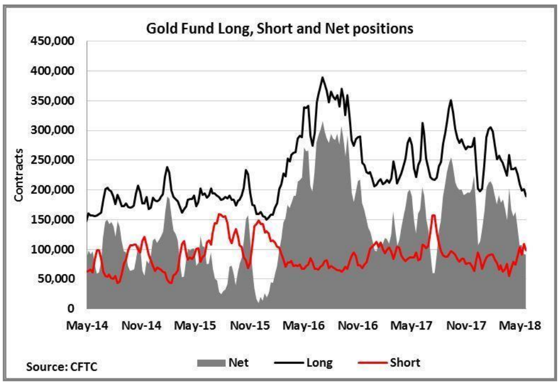


Dollar's rally a headwind for Gold prices

Up until late May the dollar had been rising at a fast pace, with the dollar index climbing to a peak of 95.03, up from a low of 88.25 in February. The chart above highlights the inverse correlation between the dollar and Gold prices. The rally in the dollar was driven by rising bond yields, which in turn have been lifted by growth being stronger in the US than in Europe and Asia. US GDP rose 2.2 percent in the first quarter, compared with 0.1 percent in the UK, 0.3 percent in Germany, 0.4 percent in the EU and -0.2% in Japan. This suggests that US monetary policy will continue to tighten, while other major economies' central banks may still be some way from tightening.

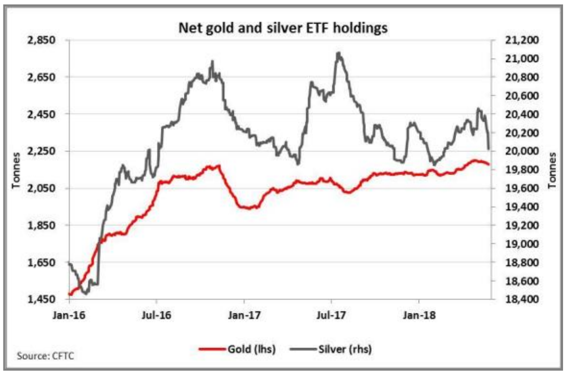
Emerging markets' stress also ignored

Interest in Gold has also been low considering the stress that is showing up in emerging markets, where currencies have been trending lower, equity markets have been declining and concerns about servicing debt have climbed as US yields and oil prices have risen. The Chinese yuan has dropped 3 percent since the late-March peak and the Indonesian rupiah and Indian rupee have dropped 6.5 percent and 7.7 percent respectively since their January peaks. Whereas Gold could have been used to hedge currency weakness, it looks like rising local Gold prices have stifled demand. Net Chinese Gold imports from Hong Kong were 38 tonnes in April, down 48 percent year-on-year, and in the first four months imports were 183 tonnes, which was down 31 percent compared with the same period in 2017. Swiss export data showed exports to Hong Kong and China totalled 43.7 tonnes in April, which was the lowest since September, and exports to India were only 26.2 tonnes in April.



Funds cut exposure in Gold

The funds trading Comex Gold continue to liquidate long positions with the gross long position falling to 189,677 contracts, from a peak in January of 305,812 contracts. Conversely, the shorts have been adding positions with the gross short position climbing to 98,720 contracts as of 22nd May, up from a low of 55,678 contracts on 27th March. The net long fund position (NLFP) has dropped to 90,957 contracts, down from a peak of 203,354 contracts in late March, and it is the lowest it has been since July 2017. This helps explain Gold's lackluster performance, but the long-drawn-out long liquidation does mean that there will be room for the longs to get back in, should sentiment turn more bullish.



Light redemptions in Gold ETFs

Investors in Gold ETFs have been reducing exposure; they have cut holdings by 22 tonnes so far in May, and now hold 2,177 tonnes across the ETFs we follow. This is down from a peak holding this year of 2,201 tonnes. Given Gold prices have fallen six percent from this year's high of $1,366.15/oz, and the opportunity cost of holding Gold has climbed as US bond yields have risen, the limited redemptions suggest investors remain fairly confident.

Bullish and bearish big picture arguments

Rising interest rates provide a conundrum for Gold investors, as on the one hand higher bond yields increase the opportunity cost of holding Gold, while on the other hand rising interest rates are a headwind for the cyclical upswing of the global economy. This is especially so for non-dollar denominated economies that have to pay for imports and service debt with dollars. A sustained run up in oil prices could add a further burden to emerging market economies that rely on imported oil. Brent crude oil prices briefly moved above $80 per barrel on concerns that Iran's exports would dry up as the US increased sanctions against the country and as oil production and exports have slumped in Venezuela. Given that equity and bond markets have generally turned lower, it could be that investors are nervous about buying into markets whose long run bull markets may be ending – they may prefer to wait for deeper corrections before bargain hunting. This could mean Gold remains a relatively cheap safe-haven to protect against broader corrections in equity and bond markets.

Technical & Summary – Another test and brief breach of the uptrend line was repelled, and prices are holding around $1,300/oz again. That said, prices are below the 20-week moving average and are therefore vulnerable. A move down below $1,280/oz would not bode well as it would open the way for a pullback to test the $1,250/oz level. Fund selling and long liquidation have added downward pressure to prices and, taking into account the strong dollar and higher US treasury yields, it is perhaps surprising that Gold prices have not fallen further. As higher US interest rates will be a headwind for the global economy (as would higher oil prices be should they rise further) and with equity and bond markets in retreat, there is a case for investment money to rotate out of bonds and equities and be parked in Gold until the corrections are over.

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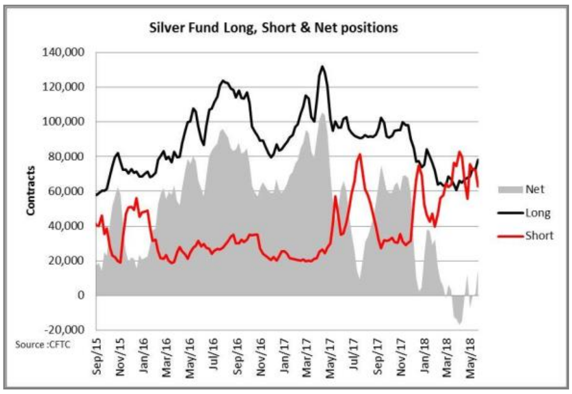
Gold Statistics	2014	2015	2016	2017	Q4 2017	Q1 2018	Apr-18	May-18
London Prices (US$/oz)								
AM fix	1266.34	1162.49	1248.16	1257.85	1276.51	1330.72	1334.38	1303.61
Pm fix	1266.20	1161.30	1248.34	1257.13	1274.35	1329.29	1334.74	1302.91
Average	1266.27	1161.89	1248.25	1257.49	1275.43	1330.00	1334.56	1303.26
Parity prices								
Australian - A$/oz	1,403	1,544	1678.88	1645.14	1,659	1,638	1,737	1,732
South Africa Rand/kg	440,562	474,410	589,051	537,559	558,876	510,684	518,473	524,426
Japan Y/g	4,146	4,355	4,203	4,370	4,463	4,464	4,450	4,432
India Rupee/oz	77,077	74,310	83,721	81,767	82,499	85,492	87,487	87,897
COMEX - futures contracts								
Stocks ('000oz)	8,203	7,422	8,962	8,860	8,970	9,151	9,050	9,017
Vol (million contracts)	40.52	41.76	51.84	72.80	20.47	14.11	6.65	~
OI ('000 contracts)	380	418	550.71	479.85	511	518	508	508
CFTC (futures only data)								
Net Spec position Long (Short)	98,265	88,022	201,250	163,493	166,887	198,919	136,646	90,957
TOCOM								
Stocks ('000oz)	146	127	120	73	60	57	63	74
Volume ('000 contracts)	8,744	7,928	8,540	5,750	1,524	1,544	630	600
OI ('000 contracts)	88	94	88	87	98	101	88	95
Other Indicators								
FT Au Mines Index	1,409	1,061	1,579	1,521	1,472	1470	1,435	1,439
Dow Jones Index	16,837	17,524	18,062	21,990	24,113	25,094	24,137	24,457
US$ Index	83.0	96.7	97.1	96.0	93.3	89.9	91.8	94.1
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 continue to trade sideways and have held up better than Gold prices

After seeing off a break of support in early-May that saw prices as low as $16.053/oz, prices have returned to trading either side of the 20-day moving average, which is around the $16.50/oz level. Prices have generally been stuck in a sideways range since the start of February, save for April's spike up to $17.355/oz on the back of a short-covering rally. Silver prices have therefore managed to avoid being pulled down by Gold's second down leg that was seen in the first part of May. This in turn has led to the Gold/Silver ratio falling back to 79, from 82.50 in April. At 79, the ratio is still high when compared to the 64.0 to 82.9 range seen since the start of 2016.

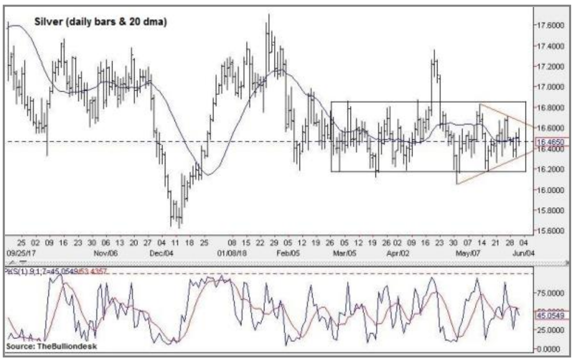


Will funds shorts get nervous?

The net fund position has been switching between net short and net long since late-February. During the first two weeks in May it was net short, but since then it has returned to being net long. As of 22nd May it was net long 15,225 contracts, the largest net short position being 16,965 on 3rd April. The gross short position is large and given that Silver prices have not followed Gold prices lower in May, this could start to prompt more short covering. CFTC data up to 22nd May showed shorts covered 9,223 contracts, taking the gross short position to 62,782 contracts, but as the red line on the chart above shows, the gross short position remains high. Conversely, the gross long position is relatively low, so there is potential for fresh buying as well as short covering. Another short-covering rally could lead to another spike-up in Silver prices as was seen in April.

Investors reduce exposure

ETF investors have been redeeming Silver, and holdings have fallen to 20,026 tonnes so far in May, from 20,240 tonnes at the end of April; see chart in Gold section. Holdings in the Silver ETFs we follow have ranged between 19,850 and 20,460 tonnes so far this year.



Technical – Silver prices remain in the sideways trading range as depicted by the rectangle on the chart that has contained prices most of the time since late-February. More recently, prices have also been trading within a triangle, which may mean a breakout is approaching - the apex of the triangle is around 20th June. At the time of writing, resistance from the triangle is at $16.67/oz and support is at $16.31/oz.

Summary – Subdued economic data points to a loss of growth momentum in the global economy and that has meant consumers feel in no need to chase prices higher. The fact there was little follow-through buying following the mid-April rally attests to that. With potential for another short-covering rally to unfold, we would expect a repeat performance with a short-covering rally turning into an upward spike. That said, a pick-up in economic activity could lead to consumer restocking and if that were to happen then the base metals could well extend gains and that would likely support industrial demand for Silver too.

Silver Statistics	2014	2015	2016	2017	Q4 2017	Q1 2018	Apr-18	May-18
London Prices (US$/oz)								
Daily Fix	19.08	15.71	17.10	17.05	16.70	16.77	16.61	16.47
Parity (London) prices								
Japan (Y/g)	70.31	58.92	57.46	59.27	58.44	56.29	55.38	56.00
India (Rupee/oz)	1,312.5	1,004.7	1,147.5	1,109.5	1,080.4	1,078	1,088.8	1,110.7
COMEX – futures contracts								
Stocks (Moz)*	178.9	171.6	162.1	210.8	237.4	253.8	263.6	270.5
Vol (million contracts)	13.7	13.5	17.0	23.0	5.8	4.0	2.6	~
OI (‘000 contracts)*	155.8	169.6	188.8	191.6	169.9	191.8	194.6	194.6
CFTC (Futures Only Data) non-commercial								
Net Positions *	19,307	31,269	69,366	56,301	33,731	4,639	11,967	15,225
TOCOM								
Stocks (Moz)*	0.2	0.16	0.16	0.18	0.11	0.14	0.13	0.14
Futures Vol (‘000 contracts)	86.1	62.6	61.1	20.6	4.5	4.1	2.1	1.4
Futures OI (‘000 contracts)*	4.5	3.1	3.3	1.8	1.6	1.9	1.8	1.5
Other Indicators								
Gold/Silver ratio*	67.6	74.4	73.0	74.3	76.8	79.5	79.5	78.9
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					

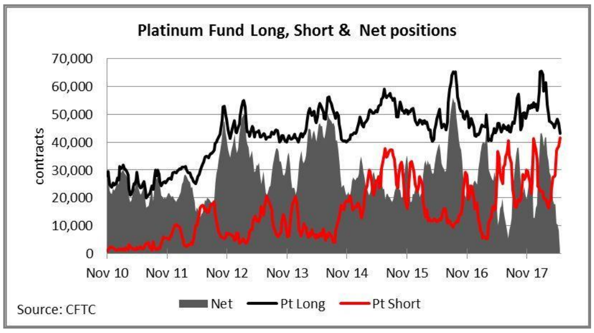
* figures are period averages unless marked; ~ not available yet, *italics* = estimate.

Platinum has followed Gold's lead, while Palladium prices have been rangebound

Platinum prices sold off in the first part of May and set a low at $877/oz on 21st May; they have since rebounded to $905/oz. Palladium on the other hand has traded more like Silver and the base metals, with prices oscillating sideways. Platinum prices continue to suffer as sales of diesel cars in Europe struggle, while Palladium prices continue to consolidate having pulled back from the rapid gains seen in 2017 and early-2018. Palladium prices, like most of the other industrial metals, are waiting for economic growth to pick up again.

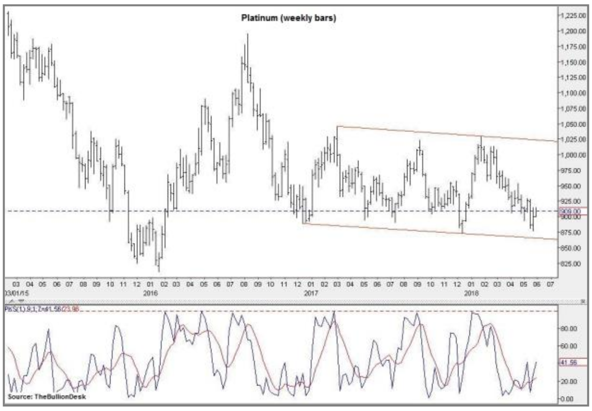
Diesel cars sales continue to fall

Diesel car sales' share of the European market continues to fall; in 2017 diesel sales accounted for 44.4 percent of the market, down from 49.5 percent in 2016 and a peak of 55.7 percent in 2011. In the first quarter, 1.57 million diesel passenger vehicles were registered, which was 17 percent lower than in the same period in 2017. However, while Platinum's use in autocatalysts is falling due to the drop in diesel car sales, it is expected that more Platinum will be used in autocatalysts for petrol vehicles, which have in recent years mainly used Palladium. The combination of the existing supply shortage of Palladium and the potential for US sanctions to affect Russian Palladium exports may prompt vehicle manufacturers to increase their use of Platinum and reduce their dependence on Palladium.



Fund

Fund longs trading Nymex Platinum and Palladium are cutting exposure at a fast pace, while shorts are building up positions in Platinum, while they are cutting exposure in Palladium. So while the froth has been taken out of the Palladium market, the net long fund position (NLFP) in Platinum is on course to switch to a net short fund position – the NLFP being at 1,462 contracts. The Platinum market is therefore vulnerable to a short-covering rally. ETF investors continue to liquidate Palladium holdings, which are down 22 percent so far this year, while Platinum holdings are off 5.2%.



Technical & Summary - Platinum prices are rebounding after another downward leg within their sideways zig-zag. Support was recently found at $877/oz, which was constructive as it was above the previous support at $873/oz. The potential for fund short-covering, combined with the upturn in the stochastics, is expected to see range trading continue, which could entail a return to the top of the range, above $1,000/oz. Palladium prices are consolidating after their first quarter correction; given the supply deficit, we expect prices to work higher, or at least remain well supported.

PGM Statistics	2014	2015	2016	2017	Q4 2017	Q1 2018	Apr-18	May-18
London Prices (US$/oz)								
Platinum	1,390	1,060	976	949	921	978	925	904
Palladium	809	692	611	869	992	1,035	970	978
Rhodium	1,180	953	694	1,101	1,477	1,826	2,074	2,134
Japanese Parity Prices (Y/g)								
Platinum	4,519	3,965	3,278	3,298	3,221	3,283	3,083	3,074
Palladium	2,636	2,587	2,050	3,020	3,472	3,478	3,234	3,325
South African Parity Prices (Rand/kg)								
Platinum	466,074	417,839	444,891	391,696	389,038	362,060	346,337	350,754
NYMEX Stocks ('000oz)								
Platinum	195.8	138.8	205.1	215.0	194.6	183.4	185.5	185.3
Palladium	347.4	134.0	71.1	50.2	49.6	41.8	41.3	40.8
CFTC Futures Only Data Long / (short) non-commercial								
Platinum	35,840	24,585	31,817	24,302	21,430	37,569	17,832	1,462
Palladium	22,276	12,080	8,765	20,660	23,565	18,564	10,961	10,715
Tocom - Platinum								
Stocks ('000oz)	46.6	53.8	57.1	47.1	54.2	56.3	53.5	65.7
Vol (Million contracts)	4.6	3.9	2.9	2.5	0.6	0.5	0.2	0.2
OI ('000 contracts)	72.6	69.7	52.7	56.8	55.0	50.6	62.9	64.5
Tocom - Palladium								
Stocks ('000oz)	3.2	5.4	11.1	3.6	1.0	0.9	0.9	1.8
Vol ('000 contracts)	77	63	30	32	9.3	7.6	4.8	2.2
OI ('000 contracts)	2.0	1.8	1.1	1.4	1.4	1.4	0.9	1.4
Other Indicators (US$/oz)								
Pt-Au spread	115	-100	-253	-320	-355	-374	-408	-394
Pt-Pd spread	568	245	369	59	-77	-16	-73	-79
Platinum Bullion imports (kg)	2014	2015	2016	2017		2018		
USA	141,413	238,740	201,412	431,277		28,132	(Jan-Mar)	
Japan	32,684	47,283	44,786	42,986		14,089	(Jan-Apr)	
PalladiumBullion imports (kg)	2014	2015	2016	2017				
USA	92,400	82,500	88,800	86,000		21,720	(Jan-Mar)	
Japan	58,429	57,223	58,860	59,492		19,661	(Jan-Apr)	

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

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