GLOBAL BANKING AND MARKETS

ScotiaMocatta

Metal Matters October 2017

Gold prices are correcting the strong gains in the third quarter – dollar strength and stale long liquidation on the stalemate over North Korea have led to the price weakness.

- The market seems to have become tired of all the rhetoric and no action over North Korea. We do not expect the calm to last.
- The Fed has turned more hawkish and seems more confident with its stance, and the dollar has rebounded accordingly – adding to the downward pressure on Gold prices.
- Physical demand does not seem to be as weak as sentiment suggests, but India's consumers face further challenges.
- Gold prices face numerous monetary policy headwinds, but these could turn out to have some bullish implications for Gold.
- We would let this correction run its course, but ultimately expect tension over North Korea to drive prices higher before too long.

Silver prices have corrected in line with Gold's pullback, but prices have found some support. With industrial metals resuming their stronger tone, Silver prices may get some lift.

- With India's consumers nervous of triggering reporting levels when they buy Gold, they may feel they get more 'bang for their buck' buying Silver.

Palladium and Platinum prices have both corrected recent gains; Palladium is holding up better than Platinum.

- Platinum may face further supply cuts in Southern Africa, which could tighten up the fundamentals.

Gold hit by profit-taking, but limited shorting suggest market not too bearish

Gold prices reached a high of $1,357.55/oz on 8th September, up from the July trough of $1,204.90/oz; they have since corrected to a low of $1,268.40/oz. After a 12.7 percent rise, with few pullbacks along the way, it is unsurprising that the market needed to consolidate. The correction retraced 58.4% of the rally, which is meaningful, but it has not damaged the overall chart picture too much. Indeed, trading at $1,270/oz at the time of writing, prices are still 13 percent above the lows seen in mid-December 2016. What is more, judging by the funds, the price weakness seems to have been driven primarily by fund long liquidation rather than by short selling, which suggests sentiment has not turned bearish per se, just become less bullish after the strong rally off the July low.

Market tires of North Korea saga

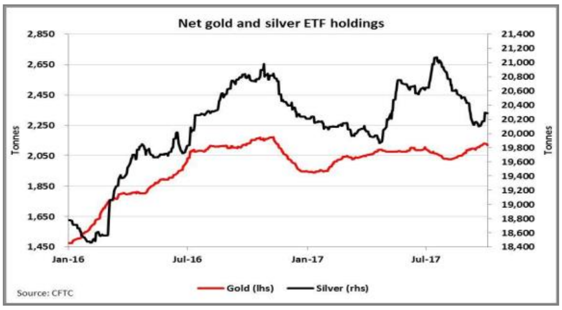
There is little doubt that the increase in geopolitical tensions over North Korea has been a main bullish driver and, with lots of fighting talk, it seems natural that safe-haven demand for Gold picked up. However, given all the rhetoric but no action/solution, it does look as though the market has grown tired of the North Korean stalemate and long liquidation has set in. Needless to say, it seems unlikely a solution will be found for the North Korea problem without tensions rising again, so this remains a bullish factor in our view.

The Fed turns more hawkish too

The profit-taking was also helped by a change in the Fed's stance from being quite dovish over the summer to being more hawkish in recent weeks. A commitment to start reducing the Fed's $4.5 trillion balance sheet is another stage in reducing quantitative easing (QE), even though it will be extremely gradual. The combination of rising US interest rates and quantitative tightening (QT) are, on the surface, headwinds for Gold prices, but they could also become negative issues for the broader markets that have thrived on the ultra-loose monetary policy. With many of the broader markets at or near record highs, any correction could prompt investors to park their wealth in safe-havens. While the US equity market is at a record high and US treasury prices have been trending higher for years, Gold prices at $1,270/oz are 33 percent below their 2011 high of $1,921/oz, but they are trending higher, so have potential to head higher still. In addition, tighter monetary policy in the US could be followed by tightening in Europe and the UK, which could start to cause issues for the mountain of global debt, which again could fuel demand for safe-havens.

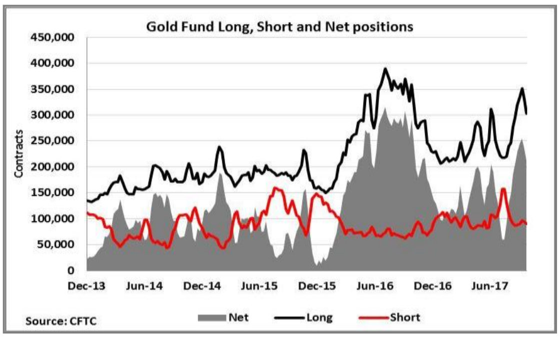
The physical market not all bad

Looking at physical Gold demand (including fabrication, central bank purchases, coins and bars, but not demand from ETFs) shows it grew seven percent in the first half of the year compared to the same period in 2016, according to data from the World Gold Council. This is quite constructive considering there seems to be an underlying feeling that demand in India and China is generally suffering. As it turns out, in India, jewellery and coin/bar buying was up 30 percent, while in China, jewellery demand was down 3.3 percent, but coin/bar investment was up 38.7%. India's strong demand is off a low base and buying accelerated ahead of the introduction of the Goods and Services Tax (GST). Collectively therefore, consumer demand in the world's two largest consumers was up 15.5 percent in the first half of the year, compared to the same period in 2016. The weakness in the overall Gold demand data has come from ETF demand; ETFs have bought 167.9 tonnes in the first half, compared with 579.4 tonnes in the same period in 2016. Indian demand may struggle to hold up in the second half as firstly, the market has had to come to terms with the GST and secondly, the gems and jewellery industries are now subject to the Prevention of Money Laundering Act. This means jewellery and gold coin/bars sales valued at INR 50,000 must be recorded along with the buyer's Permanent Account Number. The previous notification limit was INR 200,000. Since this change, jewellery retailers report that large item sales have dwindled. We imagine it will take considerable time before the country gets used to the new system and during that time luxury spending may be channeled into other premium items.



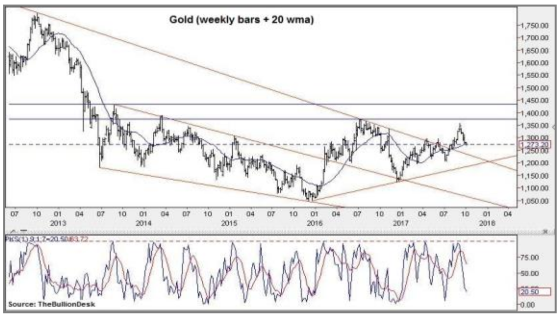
ETF investors late in, but hold steady

Considering all the geopolitical tension and the run-up in Gold prices from mid-July, ETF investors only started to increase holdings in early August. From a low of 2,025 tonnes on 4th August, holdings climbed to 2,131 tonnes on 28th September. So, having grown bullish again, investors have taken advantage of the correction to scale down buy, which is a bullish sign. Holdings have only dropped to 2,121 tonnes since peaking. The all-time high was 2,637 tonnes from January 2013.



Funds take profits, little sign of shorting

The fund net and gross long position climbed robustly since mid-July, reaching a peak of 254,760 contracts and 351,492 contracts respectively on 12th September, up from 60,138 and 217,232 contracts on 18th July. They have since dropped back to 212,594 and 303,255 contracts. During the price rally and climb in gross long position, shorts were covering and, as the red line on the chart shows, at 90,661 contracts the gross short position is near the low for the year of 80,338 contracts. The low in 2016 was 62,515 contracts. As such, it does look as though as far as the funds are concerned the selling has been long liquidation rather than fresh shorting.



Technical – Gold prices broke above the long-term down trend line (that joined the peaks in 2011, 2012 and 2016) at $1,256/oz with the rally forging higher to $1,357.55/oz, before faltering. The September high was above the November 2016 high, but below the July 2016 high of $1,375.25/oz. A move above the July high would then target the August 2013 high at $1,433.25/oz – see upper horizontal line on the chart – and a move above there would suggest prices are breaking out of a major long-term base.

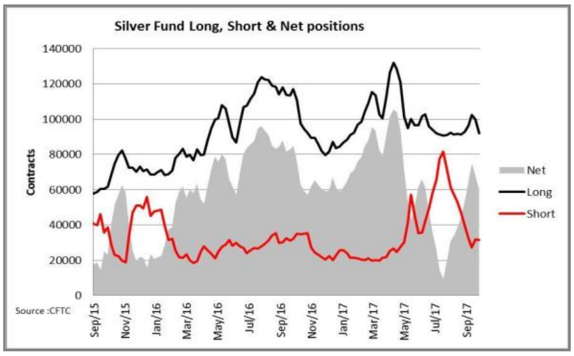
Summary – Gold prices have pulled back in recent weeks but given the stalemate over North Korea it is not surprising that some profit-taking emerged, especially with the Fed portraying a more hawkish tone and a more confident one at that. Logic would suggest a rebound in the dollar and QT would keep prices under pressure, but maybe North Korea, richly priced equity and bond markets, will see safe-haven demand for Gold grow.

Gold Statistics	2013	2014	2015	2016	Q2 2017	Q3 2017	Aug-17	Sep-17
London Prices (US$/oz)								
AM fix	1410.80	1266.34	1162.49	1248.16	1257.89	1277.96	1281.72	1317.05
Pm fix	1411.03	1266.20	1161.3	1248.34	1256.96	1277.84	1282.32	1314.98
Average	1410.92	1266.27	1161.89	1248.25	1257.43	1277.90	1282.02	1316.02
Parity prices								
Australian - A$/oz	1,454	1,403	1543.9	1,679	1,675	1637	1,620	1,707
South Africa Rand/kg	433,964	440,562	474,410	589,051	532,959	540,737	545,465	555,821
Japan Y/g	4,252	4,146	4,355	4,203	4,329	4393	4,363	4,515
India Rupee/oz	81,973	77,077	74,310	83,721	80,959	82,069	81,929	84,760
COMEX - futures contracts								
Stocks ('000oz)	8,103	8,203	7,422	8,962	8,801	8707	8,698	8,761
Vol (million contracts)	46.27	40.52	41.76	51.84	15.89	19.95	6.81	7.18
OI ('000 contracts)	398	380	418	551	467	512	566	521
CFTC (futures only data)								
Net Spec position Long (Short)	68,381	98,265	88,022	201,250	162,799	178,157	231,047	212,594
TOCOM								
Stocks ('000oz)	120	146	127	120	76	67	71	60
Volume ('000 contracts)	12,223	8,744	7,928	8,540	1,456	1,233	646	642
OI ('000 contracts)	111	88	94	88	79	92	89	106
Other Indicators								
FT Au Mines Index	1,789	1,409	1,061	1,579	1,481	1,566	1,648	1,534
Dow Jones Index	15,090	16,837	17,524	18,062	21,180	22,096	21,974	22,399
US$ Index	81.3	83.0	96.7	97.1	97.3	92.9	92.6	93.1
Gold Bullion Imports, tonnes (exports)								
Dubai	350	136	118	~				
China	2192	1297	1,610	1,281				
India	824	776	949	582				
Italy	107	103	~	~				
Japan	28	-80	-107	~				
Singapore	225	284	~	~				
South Korea	24	24	~	~				
Taiwan	20	22	30	27.5				
Turkey	266	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 correct in line with Gold, expect good underlying support

Silver's price has dropped 9.2 percent to \$16.535/oz from the September high of \$18.213/oz, which is slightly more than the 6.6 percent drop in Gold prices seen over the same period. Silver prices, however, remain an underperformer compared with Gold prices, as Silver prices are up 6 percent from the December low compared with Gold prices that are still 13 percent higher. As a result, the Gold / Silver ratio remains relatively high at 76.60; in last month's Metal Matters report it was around 74.80.



Shorts create volatility in fund position

Funds trading Comex Silver have been active - longs were strong buyers at the start of the year, while shorts were quiet, which led to the Net Long Fund Position (NLFP) climbing to 105,515 contracts in mid-April from 58,911 at the end of 2016. Shorts then started to increase exposure while longs liquidated, which sent the NLFP crashing down to 9,376 contracts in mid-July, after which it leapt back up to 74,987 contracts on 12th September. The latter has been driven mainly by short-covering. The red line on the chart shows how volatile the gross short position has been. Key now will be whether the shorts will start to increase exposure now prices are falling. We think not, it appears they have been selling into strength and taking profits into weakness; we wait to see if the longs start to bargain hunt. ETF investors bought on a scale down basis between mid-April and early July and then turned sellers early into the July rebound all the way up to 19th September when they started to buy again. Their recent activity therefore suggests they have started to buy too early and sell too soon - we wait to see if their latest pick-up in buying is better timed. With the dollar showing signs of rebounding, it may not be.

Technical - Spot Silver prices broke up above the downtrend line in August, but they have since pulled back well below and are looking vulnerable again. Ignoring the flash spike lower seen in July, the lows so far in 2017 have ranged between \$16.05/oz and \$16.12/oz, so we would expect support in that area if this pullback has further to run.

Summary – With base and precious metals correcting in September, it is not surprising that Silver prices have corrected too, especially as \$18/oz and above may have proved an attractive price for hedging by-product Silver. Despite the pullback in prices, we expect underlying demand for Silver to remain robust, especially as concerted global growth should be good for industrial demand for Silver. Also, the lower threshold of INR 50,000 for recording and reporting Gold purchases in India may well spark more interest in Silver sales as you get a lot more 'bang for your buck' buying Silver than you do Gold. Another run up in equity markets and the profit-taking opportunity of the July-September rally may have taken the shine off the precious metals, but given the worrying situation surrounding North Korea, we do not think it will be long before safe-haven demand returns. As such, this dip should provide another buying opportunity.

Silver Statistics	2013	2014	2015	2016	Q2 2017	Q3 2017	Aug-17	Sep-17
London Prices (US$/oz)								
Daily Fix	23.83	19.08	15.71	17.10	17.26	16.83	16.91	17.45
Parity (London) prices								
Japan (Y/g)	71.66	70.31	58.92	57.46	59.40	57.87	57.54	59.86
India (Rupee/oz)	1,380.7	1,312.5	1,004.7	1147.5	1,111.1	1,081.2	1,080.6	1,123.8
COMEX – futures contracts								
Stocks (Moz)*	165.9	178.9	171.6	162.1	203.5	216.5	214.8	219.2
Vol (million contracts)	14.5	13.7	13.5	17.0	6.4	6.2	2.6	1.7
OI ('000 contracts)*	136.0	155.8	169.6	188.8	201.4	192.3	184.1	185.5
CFTC (Futures Only Data) non-commercial								
Net Positions *	11,929	19,307	31,269	69365.6	56,104	44,441	53,645	60,260
TOCOM								
Stocks (Moz)*	0.1	0.20	0.16	0.16	0.20	0.16	0.15	0.19
Futures Vol ('000 contracts)	96.4	86.1	62.6	61.1	5.1	3.8	1.8	2.1
Futures OI ('000 contracts)*	4.1	4.5	3.1	3.28	1.6	1.8	1.7	1.7
Other Indicators								
Gold/Silver ratio*	60.0	67.6	74.4	73.0	75.0	75.8	74.6	76.7
Silver Bullion Imports (tonnes)								
USA	3835	3835	5464	5956				
Japan	1688	1688	1560	1833				
India	5819	5819	7954	2793				
Italy	679	796	843	675				
Hong Kong	948	948	839	659				
China (exports)	1329	1369	2054	-137				

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

Platinum prices continue to struggle, while Palladium prices hold up well

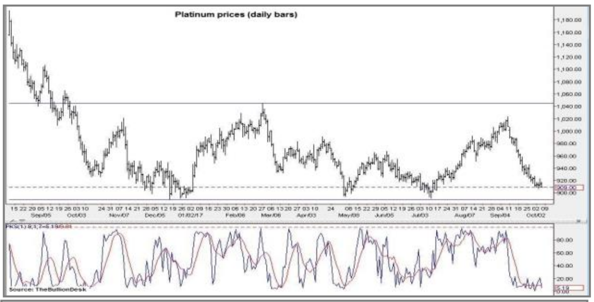
Spot Platinum prices have given back 87.8 percent of the $132.50/oz gains made in the July-September rally – the market remains unloved, which has not been helped by forecasts for the market to switch into a supply surplus this year. By comparison, Palladium prices extended gains to $1,002/oz in September to reach a 16-year high, $108/oz below the all-time high of $1,110/oz seen in January 2001. Palladium prices also traded at a premium to Platinum prices in late September, again for the first time since 2001. Since peaking at $1,002/oz, prices have corrected to $902/oz. Palladium's up trend has been steady since January 2016, with prices rising 122.7%, while at $912/oz, Platinum prices are just 12.5% above the 2016 low.

Palladium in demand, Platinum not

Palladium prices were expected to receive an extra boost after hurricane Harvey caused severe damage in the US and that has proved to be the case as US vehicle sales leapt to an annualised rate of 18.6 million units (mu) in September, from 16.1 mu in August and what had been a downward trend since December 2016's peak at 18.4 mu. In addition, Chinese car sales remain more robust than was expected, growing 4.3 percent in the first eight months of the year after extra-strong sales in 2016 of 13.7 percent. Whether sales will remain upbeat for the remainder of the year remains to be seen. Given year-to-date data, it seems that strong growth has continued despite last year's incentives bringing forward some demand. That said, if car sales do disappoint then we would expect that to have a knee-jerk negative reaction on Palladium prices. Platinum demand continues to suffer the double whammy of diesel cars losing market share combined with poor jewellery demand. In Europe, diesel car sales rose from having 14 percent share of the market in 1990 to 55.7% share in 2011; this has since slipped each year, and they had 49.5% share in 2016. In addition, Platinum jewellery demand has remained weak in China, as its price weakness has eroded its credibility as a store of value. In the first half of the year, Platinum demand from the jewellery industry declined one percent, after ten percent declines in 2015 and 2016.

Supply issues could hit Platinum

A number of South African PGM miners are struggling in the current price environment, to the extent that they are considering restructuring. Insiders suggest 65 percent of Platinum mines in South Africa are unprofitable, with some producers already announcing restructuring and another facing closure for non-compliance in its social programmes. There are also potential issues in Zimbabwe that could see mines close.



Technical & Summary - Platinum prices continue to oscillate in a broad sideways base; prices are approaching the lower levels of the base, so support should be nearby. This is especially so given potential for supply disruptions in Southern Africa. Palladium prices have fallen back from highs, a possible head and shoulder (H&S) pattern could have formed with a neckline at $910/oz, but the previous H&S set-ups was not been triggered, see red boxes on chart. Fund long liquidation is being seen in both metals; the Palladium long position is still high. For Platinum, the gross long position is approaching low ground, while the short position is mid-range. Overall, we would not be surprised to see Platinum rebound, while Palladium prices correct further, or consolidate more.

PGM Statistics	2013	2014	2015	2016	Q2 2017	Q3 2017	Aug-17	Sep-17
London Prices (US$/oz)								
Platinum	1,491	1,390	1,060	976	941	953	972	969
Palladium	727	809	692	611	818	901	910	937
Rhodium	1,061	1,180	953	694	960	1,077	1,048	1,159
Japanese Parity Prices (Y/g)								
Platinum	4,501	4,519	3,965	3,278	3,240	3,275	3,307	3,325
Palladium	2,198	2,636	2,587	2,050	2,817	3,097	3,098	3,215
South African Parity Prices (Rand/kg)								
Platinum	443,938	466,074	417,839	444,891	384,753	388,728	398,730	394,697
NYMEX Stocks ('000oz)								
Platinum	276.3	195.8	138.8	205.1	222.7	214	212.6	212.3
Palladium	656.9	347.4	134.0	71.1	45.6	47	46.2	54.1
CFTC Futures Only Data Long / (short) non-commercial								
Platinum	30,680	35,840	24,585	31,817	15,040	23,972	36,370	25,363
Palladium	22,369	22,276	12,080	8,765	20,149	21,134	23,469	20,643
Tocom - Platinum								
Stocks ('000oz)	38.1	46.6	53.8	57.1	48.4	46	44.9	48.6
Vol (Million contracts)	4.3	4.6	3.9	2.9	0.6	0.4	0.3	0.2
OI ('000 contracts)	55.7	72.6	69.7	52.7	63.6	60	56.5	56.8
Tocom - Palladium								
Stocks ('000oz)	4.4	3.2	5.4	11.1	3.6	3	3.9	1.7
Vol ('000 contracts)	79	77	63	29.6	8.1	5.5	2.7	2.9
OI ('000 contracts)	2.0	2.0	1.8	1.1	1.3	2	1.6	1.5
Other Indicators (US$/oz)								
Pt-Au spread	97	115	-100	-253	-324 -	341	-332	-369
Pt-Pd spread	754	568	245	369	94	30	62	-25
Platinum Bullion imports (kg)	2013	2014	2015	2016		2017		
USA	115,765	141,413	238,740	201,412		328,075	(Jan-Jul)	
Japan	48,336	32,684	47,283	44,786		28,106	(Jan-Aug)	
PalladiumBullion imports (kg)	2013	2014	2015					
USA	83,200	92,400	82,500	88,800		44,690	(Jan-Jul)	
Japan	58,571	58,429	57,223	58,860		40,595	(Jan-Aug)	

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

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