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GLOBAL BANKING AND MARKETS

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Metal Matters — June 2017

Gold prices are rallying as demand for safe-havens has picked up on the back of political / geopolitical issues and as physical demand is showing some signs of recovering.

- Numerous political loose ends are concerning markets – these include uncertainty over President Donald Trump's statesmanship, the UK election, and its implications for the upcoming Brexit negotiations.

- Many cross currents are also affecting the financial markets and the global economic outlook, which could lead to further risk-off across bonds and equity markets.

- Geopolitical concerns are also an issue, rhetoric over North Korea has gone eerily quiet, acts of terrorism have escalated and there is unrest in the Middle East over Qatar.

- Physical demand is recovering in India and China and the funds have started to buy again after taking profits in early May.

- A weaker dollar and the possibility the Fed may turn less hawkish are also potentially bullish factors for Gold prices.

Silver prices fell back sharply on fund long liquidation, but prices are rebounding on ETF buying and fund short covering.

- Silver imports in India jumped in April, but that may have been due to traders restocking ahead of the Goods and Service Tax announcement – imports are likely to ease for a while.

Palladium prices are rallying sharply and the refined market has tightened, but other aspects of the market look less bullish.

- Platinum prices are recovering from recent lows, but the market is struggling to keep up with Gold, let alone Palladium. A weakening auto market may act as a headwind for all PGMs.

Gold back in vogue as numerous crosscurrents impact investors' confidence

Gold prices corrected after Emmanuel Macron won the French election as it gave Europe a shot of political stability, which reduced demand for safe-havens. But, the respite did not last long as other concerns have bubbled up to the surface. There are now diverse factors worrying the markets, including President Donald Trump's domestic and international demeanor, the UK election, the approaching start to UK/EU Brexit negotiations, a possible early election in Italy and raised Middle East tensions over Qatar. In addition, there is potential for broad market corrections prompted either by the market becoming disappointed that some key US election promises have not been followed through, or by another slowdown in China's economic growth.

Political and geopolitical unrest

Numerous cross currents are buffeting the global markets; on the one hand, strong equity markets suggest robust confidence, but record high equities combined with political uncertainty in the UK, Europe and the US raises the risk of triggering a market correction. The bond market is also strong with bond yields low, but that is looking at odds with the market expectation for interest rate rises in the US and a move towards the Fed cutting its balance sheet. On top of that, the UK election, the approach of Brexit negotiations and the sudden possibility of an early Italian election all point to a period of considerable political and economic uncertainty ahead. In addition, geopolitical activity may have died down in recent weeks, save the recent pick-up in tension surrounding Qatar, but with North Korea flexing its muscles by test-firing missiles the drop in rhetoric between the US and North Korea may be something to worry about.

Slower growth – will the Fed turn dovish?

Some slowdown in US economic data, including the recent non-farm employment change, combined with falling inflation measures has raised questions as to whether the Fed will turn dovish again. The market still expects an interest rate rise at the FOMC meeting on 14th June, but their tone may soften. There is also a risk that, should China face a growth slowdown again, the global market may be less capable of withstanding higher US rates. The downturn in the dollar combined with low US treasury yields suggests expectations for further interest rate rises may be out of sync. Weaker yields and a weaker dollar are tailwinds for Gold prices.

Physical demand picking up

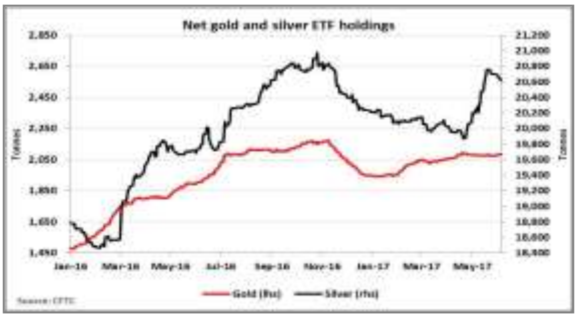
Physical demand from India and China, the world's two largest consumers, is on the rise as it recovers from the weakness seen in 2016. In India, the market is recovering from the disruptions caused initially by the jewellery retailers strike and then by the cash crunch caused when key 500 and 1000 rupee banknotes were demonetized. In the first five months of 2016, India has imported 424 tonnes of Gold, which is up 144 percent on the same period last year, albeit that was from a low base due to the jewellers' strike. However, the recent announcement that the Goods and Service Tax (GST) will be 3 percent – which is less than feared – should be good for demand, although the surge in imports in recent months is likely to have seen considerably restocking. But, with the GST announcement now known, the Indian bullion market should benefit from a more stable regulation base, something it has not had for a few years now. Demand in China also seems to be rebounding, with consumption reportedly up 15% in the first quarter, driven by demand for Gold bars, while jewellery buying remained subdued. A recovery in Gold prices may instill confidence in Gold jewellery holding its value again, as the jewellery market in recent years appears to have lost its appeal after the relentless price weakness seen between 2012 and 2015. We are bullish for investment interest in Gold in China; we see the market as having large organic growth potential as retail outlets spread to lower tier cities and as the internet and mobile apps, such as WeChat's Microgold accounts, make Gold more accessible to the upwardly mobile population.

Fund longs return as buyers

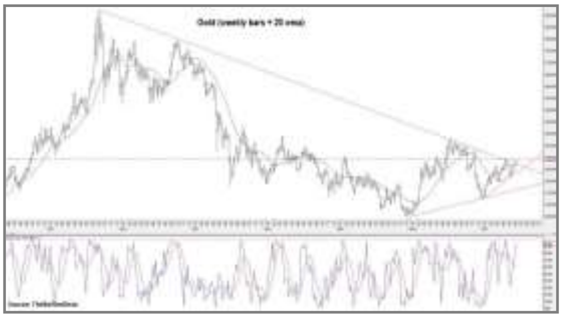
The Net Long Fund Position (NLFP) on Comex Gold dropped in the first half of May but buyers have since returned. Most of the running was initially done by longs liquidating positions – the gross long position dropped to 221,532 contracts from April's peak of 287,468, but it has since returned to 250,542 contracts as of 30th May. The sell-off did see a slight pick-up in the gross short position to 94,808 contracts from April's low of 80,338, but the short position has since dropped back to 83,452. As such, the sell-off in Gold has been driven more by longs taking profit than shorts selling. The general low level of the gross short position suggests the funds are not that bearish, while the gross long position is relatively low, meaning there is room for the funds to get more bullish again.

ETF investors not enthused

Holdings in the ETFs we follow have not changed much in recent months, indeed they dropped 5 tonnes in May, that after rising 131 tonnes in the first four months of the year. This suggests that investors have been focused on the more buoyant equity markets, rather than Gold. It does suggest that, should a broader market correction unfold, Gold ETFs may not be considered overbought and may therefore offer a safe-haven. ETF holdings stand at 2,083 tonnes – the all-time high in holdings was 2,647 tonnes, seen in January 2013.



Technical – Gold prices have rebounded strongly; they have overcome the down trend line from last summer's peak and the April high at $1,295.50/oz, albeit only just. Clearance would then put the focus on potential supply from the sideways trading that capped the market last summer and which runs between $1,302-1,375.50/oz. The weekly chart shows a large 'W'-shaped bottom may have been forming on the chart over the past two years, which could support a return to a bull market.



Summary – The fact Gold prices are managing to rally in the face of record-setting equity markets and what has up until recently been a strong dollar, seems to be a sign that there is investor demand to diversify. This year prices have also benefitted from a recovery in physical demand from India and China. Given that political and geopolitical uncertainties are unlikely to subside anytime soon, we remain bullish for Gold and expect dips to be supported.

Gold Statistics

	2013	2014	2015	2016	Q4 2016	Q1 2017	Apr-17	May-17
London Prices (US$/oz)								
AM fix	1410.80	1266.34	1162.49	1248.16	1220.46	1219.03	1267.15	1245.25
Pm fix	1411.03	1266.20	1161.3	1248.34	1217.98	1219.36	1265.63	1245.00
Average	1410.92	1266.27	1161.89	1248.25	1219.22	1219.20	1266.39	1245.13
Parity prices								
Australian - A$/oz	1,454	1,403	1543.9	1,679	1,630	1,609	1,680	1,675
South Africa Rand/kg	433,964	440,562	474,410	589,051	546,308	517,663	546,689	530,212
Japan Y/g	4,252	4,146	4,355	4,203	4,151	4,296	4,325	4,330
India Rupee/oz	81,973	77,077	74,310	83,721	82,126	81,540	81,642	80,101
COMEX - futures contracts								
Stocks ('000oz)	8,103	8,203	7,422	8,962	9801	8,963	8,933	8,854
Vol (million contracts)	46.27	40.52	41.76	51.84	14.44	16.49	4.61	6.37
OI ('000 contracts)	398	380	418	551	456	429	451	494
CFTC (futures only data)								
Net Spec position Long (Short)	68,381	98,265	88,022	201,250	155,015	146,130	189,634	167,090
TOCOM								
Stocks ('000oz)	120	146	127	120	104	83	75	78
Volume ('000 contracts)	12,223	8,744	7,928	8,540	1,784	1,538	421	460
OI ('000 contracts)	111	88	94	88	90	80	79	75
Other Indicators								
FT Au Mines Index	1,789	1,409	1,061	1,579	1,516	1,568	1,445	1,577
Dow Jones Index	15,090	16,837	17,524	18,062	19,094	20,571	20,930	21,150
US$ Index	81.3	83.0	96.7	97.1	100.7	100.6	99.1	96.6
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 rebound as Gold rallies on risk-off/safe-haven demand

Silver has had a volatile time of late. Prices corrected 14 percent from the April high at $18.655/oz, dropping to $16.053/oz, but have since rebounded 10.6 percent to $17.755/oz. By comparison, Gold prices corrected 6.3 percent but are now setting fresh highs for the year again. While Silver prices have generally taken the lead from Gold, Silver's industrial attributes appear to have weighed on its performance. Given that base metals are also under pressure this is of little surprise, but we expect Silver's precious metals attributes to be more powerful than its industrial attributes. As such, we think Silver prices may have some catching up to do. The Gold/Silver ratio climbed from 68 to 76 in May and was last around 73, so a return to the high 60s may well be on the cards.

ETF holdings up 639 tonnes in May

Retail investor interest via ETFs has been strong, with ETF holdings climbing 639 tonnes in May, which suggests investors took advantage of the price pullback to build up exposure (see chart in Gold section). This is in stark contrast to Gold, where ETF investors have shown little fresh interest. Sentiment amongst ETF investors has only recently turned bullish; at their low on 21st April, holdings were 19,866 tonnes, they then climbed to 20,753 tonnes on 22nd May and were last at 20,617 tonnes. Interestingly, Silver ETFs are close to their record highs, which were 20,976 tonnes seen in October last year, while Gold ETF holdings at 2,083 tonnes are well below the 2013 peak of 2,647 tonnes.

Funds' position starts to rebound

The Net Long Fund position (NLFP) dropped sharply in recent months to a low of 43,004 contracts on 15th May, from a peak of 105,515 contracts on 11th April; it has since rebounded to 61,414 contracts. As the chart opposite shows, the correction was driven by long liquidation and short-selling, but the recent rebound has been driven more by shorts taking profits (short-covering) than by fresh buying.

India steps up Silver imports

India imported 600 tonnes of Silver in April, considerably more than the 350 tonnes imported in March. Although India (like ETF investors) took advantage of the recent price weakness, in the first four months of the year imports of 1,535 tonnes were only slightly above the 1,503 tonnes seen in the same period last year. However, with a more stable and known regulatory environment for bullion in India post the GST announcement, the industry may face less disruption going forward.

Technical & Summary – Silver prices are rebounding after the sharp correction, physical demand has improved in India and from ETF investors, but the funds have yet to return in force. However, with Gold prices looking set to break higher, investors may see relative value in Silver while the Gold/Silver ratio is reasonably high compared with the past year. As we are broadly bullish for Gold, we are too for Silver.

Silver Statistics	2013	2014	2015	2016	Q4 2016	Q1 2017	Apr-17	May-17
London Prices (US$/oz)								
Daily Fix	23.83	19.08	15.71	17.10	17.18	17.42	18.06	16.76
Parity (London) prices								
Japan (Y/g)	71.66	70.31	58.92	57.46	58.51	61.39	61.67	58.31
India (Rupee/oz)	1,380.7	1,312.5	1,004.7	1147.5	1,157.1	1,165	1,164.2	1,078.5
COMEX – futures contracts								
Stocks (Moz)*	165.9	178.9	171.6	162.1	178.2	185.7	197.0	204.5
Vol (million contracts)	14.5	13.7	13.5	17.0	4.7	4.7	2.1	1.9
OI ('000 contracts)*	136.0	155.8	169.6	188.8	175.6	203	191.8	208.9
CFTC (Futures Only Data) non-commercial								
Net Positions *	11,929	19,307	31,269	69365.6	60,029	90,926	71,367	61,414
TOCOM								
Stocks (Moz)*	0.1	0.20	0.16	0.16	0.19	0.24	0.10	0.31
Futures Vol ('000 contracts)	96.4	86.1	62.6	61.1	8.5	7.3	1.2	2.3
Futures OI ('000 contracts)*	4.1	4.5	3.1	3.28	2.7	2.2	1.5	1.7
Other Indicators								
Gold/Silver ratio*	60.0	67.6	74.4	73.0	70.2	69.5	75.4	73.1
Silver Bullion Imports (tonnes)								
USA	3835	3835	6952					
Japan	1688	1688	1560					
India	5819	5819	7954					
Italy	679	796	675					
Hong Kong	948	948	839					
China (exports)	1329	1369	2054					

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

Palladium prices soar, while Platinum prices turn higher in Gold's slipstream

Spot Palladium prices have broken up through resistance at $833/oz , the high from March 2015, which puts the next target at $911.50/oz, the peak seen in September 2014 – the high so far has been $861.50/oz. On the surface, prices are being driven by forecasts for another supply deficit in 2017, which would be the sixth consecutive year of deficits. Although prices are bullish, there are some factors that make us question how sound the rally is. Firstly, growth in auto sales in the main markets of the USA, China and Europe are showing signs of braking and we expect growth to turn negative in China in the months ahead as year-on-year sales data is pitched against high-based data from last year. Secondly, ETF redemptions in Palladium have been large, and thirdly, fund longs have also been liquidating positions. Platinum prices on the other hand have started to recover; they have reached $967.50/oz, up from a low of $894/oz on 4th May, but with the Platinum prices trading at a $330/oz discount to Gold prices, slightly higher than the $320/oz discount a month ago, Platinum even seems to be struggling to keep up with Gold. Overall, while we do see Palladium as being in a significant mine supply deficit, extra supply is coming from ETF redemptions, while for Platinum we see the the market as being roughly balanced, but investment buying may lead to a deficit. As such, we would not be surprised to see Platinum prices rally further, while Palladium prices may struggle, at least once this short-covering rally has run its course.

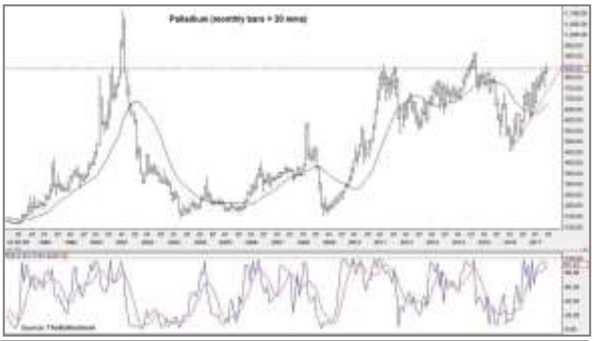
Funds take profits in Pd, but buy into Pt

The Net Long Fund Position (NLFP) in Palladium climbed to 21,493 contracts on 2nd May, which was up from 4,969 contracts in November 2016, but it has since fallen to 17,916 contracts. The drop has come mainly on long liquidation. The NLFP in Platinum has climbed to 17,046 contracts from 10,240 contracts on 9th May, however, the increase in the NLFP has been mainly driven by 9,967 lots of short-covering, while over the same period longs have been liquidating.

With the gross short Platinum position still large and the gross long position low, there may well be room for the NLFP to advance.

Pt & Pd ETF investors interest diverge

Holdings in Palladium ETFs stand at 1.51 million ounces (Moz), down from 1.71 Moz at the start of the year. Conversely, holdings in Platinum ETFs stand at 2.49 Moz and are up from 2.34 Moz at the start of the year.



Technical & Summary - The Palladium chart, showing monthly bars, shows how strong prices are but also that prices have tended not to stay up at these levels for long, so as such we would be cautious. The Platinum chart, showing daily bars, shows the latest price recovery. We wait to see if prices can overcome the down trend line at $970/oz and the April peak at $990.50/oz. Given our bullish outlook for Gold prices, we would not be surprised to see Platinum prices recover further.

PGM Statistics	2013	2014	2015	2016	Q4 2016	Q1 2017	Apr-17	May-17
London Prices (US$/oz)								
Platinum	1,491	1,390	1,060	976	945	981	961	930
Palladium	727	809	692	611	684	765	799	793
Rhodium	1,061	1,180	953	694	754	891	965	934
Japanese Parity Prices (Y/g)								
Platinum	4,501	4,519	3,965	3,278	3,153	3,454	3,282	3,233
Palladium	2,198	2,636	2,587	2,050	2,288	2,693	2,729	2,757
South African Parity Prices (Rand/kg)								
Platinum	443,938	466,074	417,839	444,891	407,084	404,263	400,086	381,659
NYMEX Stocks ('000oz)								
Platinum	276.3	195.8	138.8	205	237.3	228	217.5	225.7
Palladium	656.9	347.4	134.0	71	66.7	58.8	52.3	42.8
CFTC Futures Only Data Long / (short) non-commercial								
Platinum	30,680	35,840	24,585	31,817	24,241	36,765	17,541	17,046
Palladium	22,369	22,276	12,080	8,765	11,138	17,794	21,493	17,916
Tocom - Platinum								
Stocks ('000oz)	38.1	46.6	53.8	57	48.6	42.1	40.8	52.4
Vol (Million contracts)	4.3	4.6	3.9	2.9	0.7	0.9	0.2	0.2
OI ('000 contracts)	55.7	72.6	69.7	53	59.4	48.5	57.8	63.6
Tocom - Palladium								
Stocks ('000oz)	4.4	3.2	5.4	11	10.6	5.7	3.2	3.9
Vol ('000 contracts)	79	77	63	30	9.1	9.1	2.1	2.3
OI ('000 contracts)	2.0	2.0	1.8	1	1.0	1.2	1.3	1.3
Other Indicators (US$/oz)								
Pt-Au spread	97	115	-100	-253	-248	-261	-314	-340
Pt-Pd spread	754	568	245	-369	-263	-190	-102	-111
Platinum Bullion imports (kg)	2013	2014	2015	2016		2017		
USA	115,765	141,413	238,740	201,412		62,811	(Jan-Mar)	
Japan	48,336	32,684	47,283	44,786		13,089	(Jan-Apr)	
PalladiumBullion imports (kg)	2013	2014	2015					
USA	83,200	92,400	82,500	88,800		19,440	(Jan-Mar)	
Japan	58,571	58,429	57,223	58,860		20,141	(Jan-Apr)	

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

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