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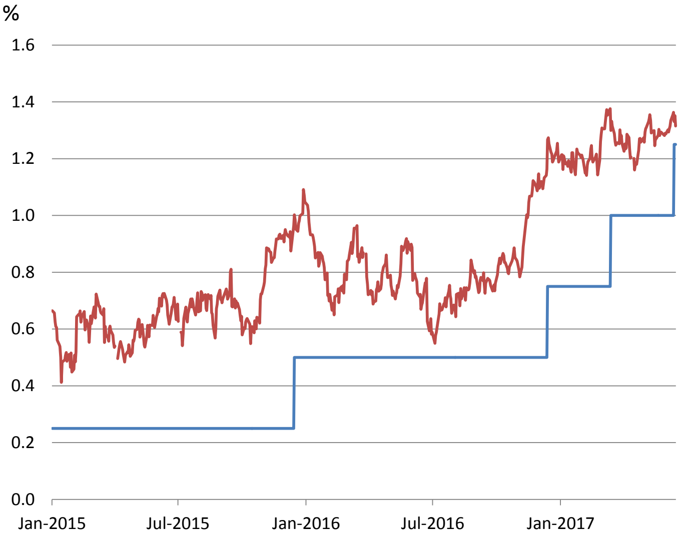
Precious Metals Weekly Update

19th June 2017

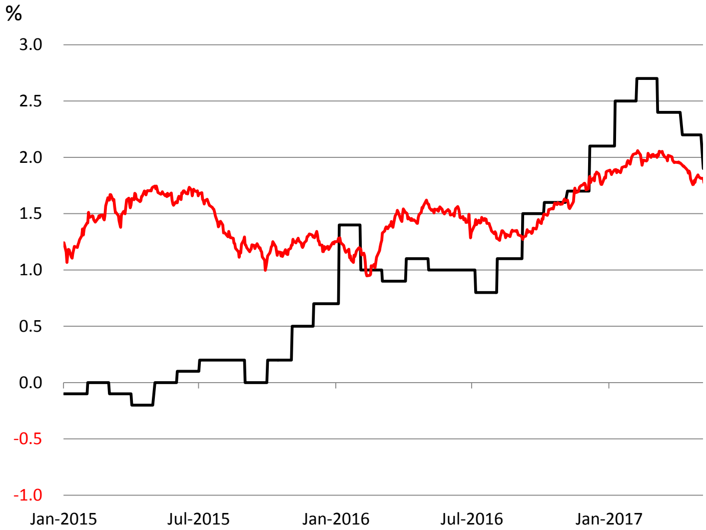
WEEK IN REVIEW: US raises interest rates again

The US Federal Reserve last week raised interest rates for the fourth time since the global financial crisis, and the second time this year, lifting the upper target rate to 1.25%. While this was widely expected, the Fed managed to strike a reasonably hawkish note as it maintained its forecast of one more rate rise within 2017 and announced a strategy for reducing its $4.5 trillion balance sheet later this year by ceasing to reinvest in maturing Treasury and mortgage debt securities. This helped the dollar and rate-sensitive 2-year US Treasury yields to advance while putting downwards pressure on gold, which touched a 3-week low of $1,252.

US interest rates and near term yields converge: implies limited market expectations of further rises from here



5-yeart inflation expectations undershoots current CPI readings: market expects that inflation will remain low in next 5 years



Sources: Mitsubishi from Bloomberg

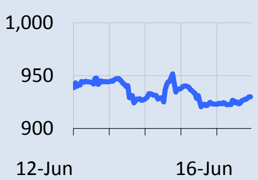
The Fed also revised key economic metrics in its quarterly consensus forecasts, lifting 2017 GDP growth projections modestly to 2.2% while anticipating a further fall in unemployment. Core inflation forecasts for 2017, as measured by the personal consumption expenditure index, was revised downwards to 1.7% from the Fed's previous projection of 1.9% but is expected to reach the targeted 2% level in 2018 and 2019. This will justify three 0.25% interest rate increases in 2018 according to the Fed's updated 'dot plot' of median forecasts which, assuming there is one more rate hike this year, would leave headline rates at 2.25% by the end of 2018. This is still very low compared with the 30 year historical average of 3.5%, and the market remains unconvinced it will get that far that fast: the Fed funds futures market gives only a 50% probability of another rate hike this year.

Gold has perhaps taken more of a battering than may be justified given the rate rise was already anticipated and the rate hike path remains largely unchanged. The emphasis by the Fed on shrinking the balance sheet does have the potential to make the macro environment less favourable to gold if it means that, with less demand from Fed re-investment, the yield on US Treasury debt rises. If inflation also remains stubbornly low, this would mean that real interest rates rise, thus increasing the cost of carry for non-yielding precious metals. A great unknown in Fed-watching remains the three current unfilled vacancies on the Federal Reserve Board, plus a possible new Chair and two new Vice-Chairs who are due to be in place by the end of next year. Particularly interesting are the possible candidates for the Fed Chairmanship, who include Prof. Marvin Goodfriend, a high profile economist who has previously argued in favour of gold-friendly negative interest rates. Overall, despite the Fed ratcheting up the hawkish tone this week, we believe that macroeconomic conditions will remain quite favourable to gold over the short to medium term.

Platinum

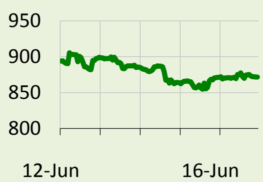
Platinum continues to suffer as a precious metal that is neither fish nor fowl – not 'industrial' enough to benefit as palladium has done from recent demand and not enough of a safe haven asset to benefit as gold has done from geopolitical concerns. The white metal slumped to a five-week low of $919 on Friday.

Platinum prices $/oz
last week:



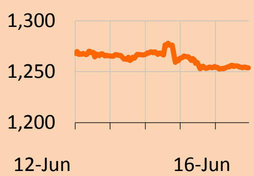
Change: **-1.3%**
Support: $894
Resistance: $950
Outlook:

Palladium prices $/oz
last week:



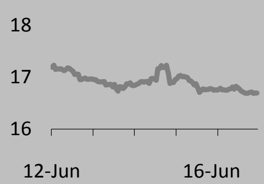
Change: **-2.2%**
Support: $840
Resistance: $928
Outlook:

Gold prices ($/oz)
last week:



Change: **-1.1%**
Support: $1,219
Resistance: $1,300
Outlook:

Silver prices ($/oz)
last week:



Change: **-2.9%**
Support: $16.20
Resistance: $17.70
Outlook:

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There was a substantial increase in gross short positioning in the NYMEX non-commercial futures market last week. After four weeks of short covering, bearish bets increased by 341 koz (24%) which offset an advance in the gross long book and left net long positioning at a four-week low of 982 koz.

New passenger car registrations in the European Union rose by 7.6% in May, to 1.39 million units, according to data released last week from ACEA, the European vehicle manufacturers' association. May's total also marked the highest since the pre-crisis peak of May 2007. This marked a recovery after a poor reading in April, which was affected by the timing of Easter: in the first five months of 2017 EU new car sales have risen 5.3% YOY, though this represents a slowdown compared with the cxx rate of growth compared with a year ago. Countries with a high diesel market share performed the strongest, with Germany (+12.9%) and Spain (+11.2%) marking the highest percentage gains. Assuming that higher sales translate into higher vehicle production this should be good for platinum demand.

Palladium

Palladium hit 16-year spot highs of $928 on 9th June on strong speculative investment interest. This stimulated a scramble for metal among industrial users, which helped push the forward market into a deep backwardation, leading to a temporary spike in lease rates. Profit taking, combined with industrial purchasers having to cover their requirements, has seen both the spot and forward markets ease as substantial volumes have been released from ETFs, though the still price remains relatively elevated.

Palladium prices jumped to a 16-year high on Friday 9th June of $928 as investors and industrial users alike scrambled to cover their requirements, at the same time pushing the forward market into backwardation across a suite of tenors. While the market has eased somewhat due to investor profit taking, metal for immediate delivery continues to trade at a premium to forwards. A notable feature about the recent market tightness is that it has predominantly affected ingot, which has traded at a premium to sponge in a reversal of the normal situation – this indicates that it is investment, rather than industrial demand that is the main driver.

In contrast to the last time palladium got above $900, in 2014, there are no obvious 'smoking guns' for higher prices – back then, the combination of a 5-month strike in South Africa had left producers with depleted pipelines, there were fears that sanctions in the aftermath of the Crimea conflict would limit Russian supplies of palladium to the market (though this never materialized), plus two new South African ETFs launched that year had accumulated close to 1 Moz of palladium. None of these factors are evident this year, rather it has been strong industrial demand combined with speculative investors determinedly driving prices towards parity or perhaps even a premium against platinum.

The tightness in the palladium market has been building for some months – we have previously commented on the backwardations in the near term forward market, which have existed since the beginning of this year. This is ultimately the result of fundamental supply-demand factors: after 5 years of deficits and the drawdown of above-ground stocks to bridge these shortfalls, as well as projections of sustained deficits for the next several years, there have been relatively few willing sellers of palladium ingot. In this classic speculative squeeze, sentiment now seems to be turning as investors look to book profit, and as some industrial users choose to purchase rather than borrow palladium – thus easing conditions in the forward market while supporting the spot price. This has been evident in the palladium exchange traded fund (ETF) market, where close to 60 koz (4% of total holdings) were liquidated last week according to the latest data as investors took profit and became willing sellers to industrial users.

Gold

Gold dropped back last week on a stronger dollar and a rally in Treasury yields after last week's interest rate rise and a more hawkish-sounding Fed.

While last week's US interest rate rise was widely anticipated, some were taken by surprise by the Fed maintaining its expectation of a further rate hike this year and three more next year despite weak recent inflation readings. The latest rate hike has seen the upper bound of the Fed funds target rate converge with the 2 year Treasury yield – indicating that market expectations for further rate hikes in the near future are limited. Similarly 5 year breakeven inflation expectations remain below 2%, suggesting that inflation will remain too low for the Fed to raise rates aggressively – all of this should be good news for non-yielding precious metals.

In the physical market, gold imports into India rose fourfold to around 4 Moz in May, according to data from the Finance Ministry. This was largely driven by pre-buying by jewellery manufacturers looking to build stock ahead of the implementation of a new Goods and Services Tax (GST) from 1st July. The GST for gold has been set at 3%, a move which was welcomed by many in the bullion industry as this represented a lower level than the 5% feared by some.

Geopolitical factors, which have been supportive of gold in recent weeks, continue to play to gold's strengths as a risk hedge. While the winning of a large majority by President Macron's party in the French National Assembly this weekend lifts the prospects of economic and political progress in France and perhaps the wider EU, Britain's recent inconclusive election introduces new uncertainties, particularly to the process of negotiating its exit from the EU, which begins this week. We recently presented on the subject of economic and political uncertainty in Europe and implications for gold at the IPMI's European Chapter – please get in touch for a copy of this presentation

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Silver

Silver slumped to a 1-month low of $16.70 following the FOMC rate decision last week. With silver now trading at close to a two-month low against gold (75:1 on the gold: silver ratio), silver looks undervalued on both a relative and absolute basis

Net speculative silver futures positioning on COMEX was pared back last week after three straight weeks of gains, mirroring a similar move in gold speculative positioning. Silver ETFs were also sold off heavily last week as investors cut back silver exposure amid the recent downwards momentum. Physical demand in the coin market remains very subdued, with American Eagle silver coin sales running at the lowest monthly total since December 2016, at 434 koz.

ECONOMIC CALENDAR: Source – Mitsubishi from Bloomberg

19-Jun	20-Jun	21-Jun	22-Jun	23-Jun
Japan: Trade balance, May (prev. Y481.7bn, exp. Y43.3 bn) **UK/EU:** Brexit negotiations formally begin	**China:** PBOC governor speech. **UK:** BoE governor Carney speech. Unemployment (prev. 7.2%, exp. 7.1%). **US**: Q1 current account balance (prev. $112.4bn, exp. $123.6bn). Fed Evans speech	**Japan:** BoJ April minutes. All industry activity index (prev. -0.6%, exp. 1.6%). **US**: MBA mortgage applications (prev. 2.8%). Existing home sales (prev. 5.57m, exp. 5.55m).	**EU:** Consumer confidence (prev. -3.3, exp. -3.0) **US**: initial jobless claims (prev. 237k, exp. 240k).	**Japan:** Nikkei Japan PMI Manufacturing (prev. 53.1). **EU:** Eurozone manufacturing (prev. 57.0, exp. 56.8) **US**: ISM manufacturing PMI (prev. 52.7, exp. 52.9). New home sales (prev. 569l, exp. 591k).

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DATA BANK: Source – Mitsubishi from Bloomberg

Metal Price Indications (US$/oz)	Platinum	Palladium	Gold	Silver
Current spot price	927	869	1,251	16.65
Change from yesterday's close (%)	-0.28	-0.34	-0.19	-0.33

Metal Forward Swap Indications (basis points)	1m	3m	6m	12m
Platinum				
Mid point of spreads	105.00	105.00	112.00	125.00
Daily change	0.00	0.00	0.00	0.00
Palladium				
Mid point of spreads	-400.00	-400.00	-400.00	-400.00
Daily change	0.00	0.00	0.00	0.00
Gold				
Mid point of spreads	135.00	140.00	142.00	145.00
Daily change	-1.00	1.00	0.00	0.00
Silver				
Mid point of spreads	145.00	152.00	163.00	170.00
Daily change	0.00	0.00	0.00	0.00

PGM Sponge Indications ($/oz)	JMUK sponge vs. Zurich ingot switch
Platinum	
Mid point of spreads	0.00
Palladium	
Mid point of spreads	0.00

LIBOR (%)	1m	3m	6m	12m
USD LIBOR Indication	1.21	1.27	1.43	1.73
Daily change	0.00	0.01	0.01	0.00

Foreign exchange indications	EUR / USD	USD / JPY	ZAR / USD	DXY
Latest	1.12	111.08	12.80	97.20
Daily change (%)	0.02	-0.18	0.09	-0.04

Non commercial futures	Platinum	Palladium	Gold	Silver
As at 13th June 2017				
Net long position (Moz)	1.0	2.2	20.3	359.6
Weekly change (%)	-21.9	13.0	-5.9	-4.9

Exchange Traded Funds	Platinum	Palladium	Gold	Silver
Total holdings (Moz)	2.4	1.0	60.2	665

Physical flows in China	Platinum		Gold	Silver
SGE turnover (kg)	18		28,610	60
Comparison with 30-day average (%)	-88		141	-95
Local premium /discount (%)	7.0		0.6	
Daily change (%)	107.0		100.6	

PGM basket price indications	
USD basket price per ounce	918
Daily change (%)	-0.3
ZAR basket price per ounce	11,759
Daily change (%)	-0.4

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TECHNICAL ANALYSIS: Source – Mitsubishi from Bloomberg

Platinum

Platinum is testing the lower limb of the uptrend channel that has prevailed since mid-May. Unless substantial buying interest emerges around this the $930 level, platinum is in danger of retracing all the way back to the $894 level, seen on 4th May. With platinum now trading under the first Fibonacci retracement of last year's high to this year's low, also below 50 day moving average at $943/4, and with technical momentum indicators relatively flat we believe platinum could drift lower in the short term.

Palladium

One has to go all the way back to 2001 to see palladium last trade as high as it did on 9th June, at $928. In moving this high, palladium broke out of the long term downtrend that linked the 2001 and 2014 highs, and also broke out of the uptrend channel has prevailed since early 2016. Palladium has now retreated back to sub-$900 and therefore back into the medium term uptrend channel, though having marked a new resistance level at $928 could well break upwards again on a renewed speculative squeeze. From the lows of May to the recent highs, palladium has traded in a ~$170 range. The mid-point of this is $840 where we believe interim support lies.

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Gold

Gold is currently finding support around the $1,249/50 level, which coincides with the 50% retracement of last July's highs to last December's lows. This has proved to be a substantial support level since March of this year. It is also in the convergence zone of the 100 day moving average. However a recent bullish golden cross was formed by the 100 day moving average breaking above the 200 day moving average.

Silver

Silver once again finds itself back below $17.00, a support level that has proven to be quite solid throughout this year. Silver is also trading below the 23.6% Fibonacci retracement of 2016's high to low at $16.93 and while there remains further downside from here, support from the December low to May low trend line is currently coming in at around $16.20.

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Spot *Forwards* *Leases* *Futures* *Options* *Swaps*
Gold *Silver* *Platinum* *Palladium* *Rhodium* *Ruthenium* *Iridium*

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