

FICC Research

Commodities: Daily

Focus: Gold could drop below \$1,300 in December



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Walter de Wet, CFA*
Walter.DeWet@standardbank.com

Leon Westgate*
Leon.Westgate@standardbank.com

Focus: Much of the commodity strength, and dollar weakness, of recent weeks comes from expectations of further quantitative easing (dubbed "QE II") by the Fed. Just how much of this is already priced in will be key for commodities, gold in particular. We use gold's strong causal relationship with global liquidity to estimate how much QE the gold market is already pricing in.

- As with the rest of the commodities complex, the focus for base metals remains global macro-economic policy and its effect on currencies. With China back from holiday, volumes are picking up. However, LME week is in full swing in London, and as a result, overall market interest may remain subdued.
- After gold's brief surge yesterday, the stronger dollar is now weighing down gold.
- Crude oil fell yesterday as the dollar strengthened. The trade weighted dollar index closed up by 0.15% yesterday, while front-month WTI closed the session down 45c/bbl. Front-month WTI, Brent, ICE gasoil and Nymex heating oil all closed below their 5-day and 8-day moving average, with only Nymex RBOB as the exception staying above the 5-day and 8-day moving average.

Commodity price data (11 October 2010)

Base metals LME 3-month									
	Open	Close	High	Low	Daily change	Change (%)	Cash Settle	Change in cash settle	Cash – 3m
Aluminium	2,421	2,400	2,395	2,374	-20	-0.83%	2,391.00	70	-35.75
Copper	8,325	8,290	8,310	8,183	-10	-0.12%	8,335.50	231	-7.00
Lead	2,301	2,315	2,315	2,286	45	1.98%	2,270.50	72	-29.00
Nickel	24,500	24,325	24,330	23,865	-25	-0.10%	24,470.00	765	-40.00
Tin	26,290	26,200	26,200	25,700	-200	-0.76%	26,395.00	370	3.00
Zinc	2,328	2,330	2,346	2,315	41	1.79%	2,302.00	70	-28.25
Energy									
	Open	Close	High	Low	day/day	Change (%)			
ICE Brent	83.41	82.95	83.41	82.78	-0.77	-0.93%			
NYMEX WTI	81.94	81.39	82.15	81.28	-0.82	-1.01%			
ICE Gasoil	719.50	714.50	719.50	714.50	-8.25	-1.15%			
API2 Q3'10	96.60	97.40	-	-	0.80	0.82%			
EUA Dec10	15.56	15.83	-	-	0.27	1.74%			
Precious metals									
	AM Fix	PM Fix	High bid	Low offer	Closing bid	Change (d/d)	EFPs		
Gold	1,348.50	1,351.50	1,355.00	1,341.30	1,353.50	9.00	0.6/1.0		
Silver	-	23.08	23.65	23.07	23.30	0.21	0.0/2.0		
Platinum	1,697.00	1,686.00	1,709.00	1,685.00	1,688.00	-16.00	1.0/3.0		
Palladium	588.00	584.00	590.00	585.00	586.00	-	1.0/3.0		

Sources: Standard Bank; LME; BBG

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Focus: Gold could drop below \$1,300 in December

Much of the commodity strength, and dollar weakness, of recent weeks comes from expectations of further quantitative easing (dubbed "QE II") by the Fed. Just how much of this is already priced in will be key for commodities, gold in particular. We use gold's strong causal relationship with global liquidity to estimate how much QE the gold market is already pricing in.

Empirically, we find the long-term causal drivers of gold are *global liquidity* and *real interest rates* (see *Commodities Insight: Global liquidity and real interest rates support gold* of 11Aug'10). We define global liquidity as *the Fed's balance sheet plus global foreign reserve holdings (excluding gold)*. Gold trades around the long-term trend these two variables provide. All other factors are short-term drivers.

Lately, gold has diverged by some margin from the long-term trend provided by these causal drivers. Divergence by gold from this long-term trend is not unusual, but the speed, size and timing of its divergence coincide with the increasing expectations for further QE. We find that:

- **Firstly**, for global liquidity to be consistent with the current gold price around \$1,350, the Fed would have to expand its balance sheet by \$500bn.
- **Secondly**, a gold price closer to \$1,280 would be consistent with the Fed announcing no further QE.
- **Thirdly**, should the Fed provide \$1trn in additional QE, a gold price closer to \$1,400 should follow.

There are many different estimates of the possible size of another round of QE, ranging from \$100bn per month, staggered over a number of months, to a \$1trn shock-and-awe infusion. The market

Base metals

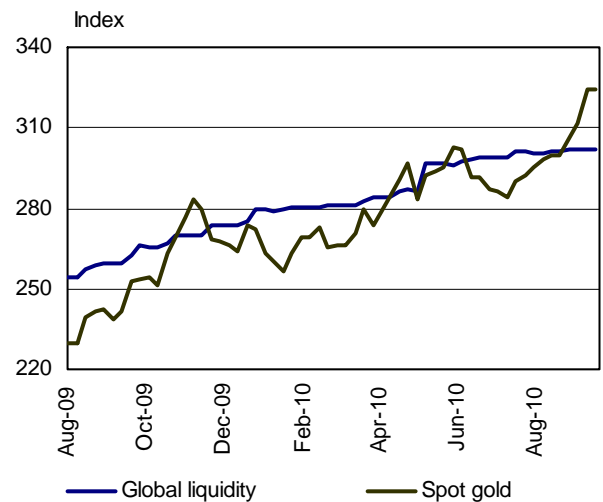
As with the rest of the commodities complex, the focus for base metals remains global macroeconomic policy and its effect on currencies. With China back from holiday, volumes are picking up. However, LME week is in full swing in London, and as a result, overall market interest may remain subdued.

Although there is some buying interest in copper in Shanghai, the LME/SFE arbitrage ratio remains low — at 7.53 this morning. This ratio still favours no aggressive LME buying from China. However, we continue to notice signs of a tightening copper market, with time spreads tightening and premia in Asia remaining firm despite the latest rally in copper.

Zinc continues to find support above the \$2,300 level. However, there may be some concern over a possible downward correction in zinc as demand for puts seem to be on the increase (with open interest in Dec'10 puts rising). We expect the zinc market to be in a 298K mt surplus in 2010 and 98K mt surplus next year. In contrast, we expect lead to push higher. Lead has lagged zinc in recent days but, fundamentally, we continue to see support for the metal into 2011, with a deficit in the lead market estimated at 67K mt for 2011.

We believe that base metal prices will be driven by expectations of further easing by the Fed until the FOMC meets on 3 Nov'10. We therefore look to macroeconomic themes in the next two weeks, rather than metal specifics.

Gold vs. global liquidity



Source: Standard Bank

will be searching the minutes of the September FOMC meeting for clues on further QE.

With our belief that gold is pricing in substantial QE already, combined with the fact that scrap continues to come to the market at the current gold price, a conservative approach on QE by the Fed could see gold drop below \$1,300 in November. This may be amplified by seasonal jewellery demand (which we expect to decline in the December).

While we remain bullish on gold into 2011, we could even see gold at \$1,260 - a point at which major technical support lies.

By Walter de Wet

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Precious metals

After gold's brief surge yesterday, the stronger dollar is now weighing down gold. Physical demand has all but evaporated, and investors are in a tentative mood ahead of the release of the FOMC minutes — awaiting signals of further quantitative easing. We estimate the current gold price implies about another \$500bn of monetary accommodation from the Fed. However, fixed income markets seem to be looking for an additional \$1tr, which would place considerable upward momentum on gold. However, the Fed may decide to stagger additional QE instead of flooding the market.

Gold support is at \$1,339 and \$1,330. Resistance is at \$1,355 and \$1,362.

Silver continues to mirror movements in the gold market, with the stronger dollar stifling physical buying. Silver support is at \$22.86 and \$22.64, resistance is at \$23.47 and \$23.84.

PGM's should react similarly to signs of more monetary accommodation in the FOMC minutes. However, the response might be downplayed by concerns over a faltering US economy impacting negatively on industrial demand for platinum and palladium.

Platinum support is at \$1,668 and \$1,653, resistance at \$1,705 and \$1,725. Palladium support is at \$583 and resistance at \$592.

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Energy

Crude oil fell yesterday as the dollar strengthened. The trade weighted dollar index closed up by 0.15% yesterday, while front-month WTI closed the session down 45c/bbl. Front-month WTI, Brent, ICE gasoil and Nymex heating oil all closed below their 5-day and 8-day moving average, with only Nymex RBOB as the exception staying above the 5-day and 8-day moving average.

The strike at French ports of Fos and Lavera enters its 16th day, with no ending yet to be seen. It has been reported that the La Mede Refinery with 157kbd crude distillation capacity is shutting down due to crude shortage. And seven other refineries relied on the import via the ports are reported running at a reduced rate. The strike has pushed down spot Urals Med diff vs. Dated Brent to an eight-week low of -\$1.63/bbl. Another impact has been a reduced gasoline export to the US, which boosted RBOB cracks in recent weeks.

The trend of dollar strengthening and oil weakening continues this morning. Technically, the future contracts are heading down to their 13-day moving average. Before the delayed API and ODE inventory release, the oil market will follow directions of the currency markets and its own technical signals. Other things to watch include the latest OPEC monthly report later today, followed by IEA monthly report and EIA's outlook tomorrow.

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Base metals

Daily LME stock movement (mt)

Metal	Today	Yesterday	In	Out	One day change	YTD change (mt)	Cancelled warrants (mt)	Cancelled warrants (%)	Contract turnover
Aluminium	4,327,575	4,331,600	1,975	6,000	-4,025	-301,325	226,700	5.24	264,347
Copper	372,475	372,000	1,500	1,025	475	-129,850	25,300	6.79	128,346
Lead	198,450	198,400	400	350	50	51,950	7,100	3.58	29,928
Nickel	123,474	123,222	390	138	252	-34,536	3,972	3.22	28,219
Tin	12,255	12,275	15	35	-20	-14,510	370	3.02	3,429
Zinc	610,850	611,725	-	875	-875	122,800	43,075	7.05	52,647

Shanghai 3-month forward prices

COMEX active month future prices

Metal	Open	Last	1d Change		Open	Close	Change	Change (%)
Aluminium	16,350	16,350	-85	Ali Dec'10	-	-	-	-
Copper	62,160	62,210	-400	Cu Dec'10	379	373.45	-5.50	-1.45%
Zinc	18,650	18,750	95					

ZAR metal prices (11 October 2010)

	Aluminium	Copper	Lead	Nickel	Tin	Zinc	ZAR/USD fix
Cash	16,472	57,423	15,641	168,574	181,835	15,858	6.8890
3-month	16,768	57,918	16,174	169,947	183,046	16,279	6.9865

Energy

Energy futures pricing	Price Change		Price Change		Price Change		Price Change		Price Change	
	1-month forward		2-month forward		3-month forward		6-month forward		1-year forward	
Sing Gasoil (\$/bbl)	93.77	-0.05	94.69	-0.35	95.20	-0.29	96.45	-0.36	-	-
Gasoil 0.1% Rdam (\$/mt)	714.50	-8.25	713.00	-7.00	713.25	-7.00	728.25	-2.25		
NWE CIF jet (\$/mt)	762.84	1.13	767.04	-0.51	771.39	-0.54	781.42	-1.55		
Singapore Kero (\$/bbl)	95.04	1.13	95.54	-0.30	96.10	-0.29	97.50	-0.36		
3.5% Rdam barges (\$/mt)	457.10	-2.60	458.75	-3.50	461.00	-3.25	469.65	-3.10		
1% Fuel Oil FOB (\$/mt)	470.87	-3.93	477.25	-5.25	482.50	-5.00	495.90	-5.10		
Sing FO 380 Cargo (\$/mt)	100.15	-	100.15	-	100.15	-	100.15	-		
Sing FO180 Cargo (\$/mt)	477.56	-2.86	482.00	-4.00	485.00	-4.00	493.40	-3.10		
Thermal coal	Q4-10		Q1-11		Q2-11		Cal 11		Cal 12	
API2 (CIF ARA)	97.40	0.80	97.90	0.40	99.20	0.40	99.95	0.45	106.75	0.55
API4 (FOB RBCT)	90.80	0.20	93.50	0.40	94.80	0.40	95.55	0.45	100.85	0.45

Precious metals

Forwards (%)	1-month	2-month	3-month	6-month	12-month		
Gold	0.37200	0.39800	0.41800	0.47400	0.48800		
Silver	0.58400	0.59400	0.60400	0.62200	0.61400		
USD Libor	0.25625	0.27297	0.28906	0.45656	0.76694		
Technical Indicators	30-day RSI	10-day MA	20-day MA	100-day MA	200-day MA	Support	Resistance
Gold	68.92	1,332.36	1,309.49	1,237.38	1,186.12	1,339.00	1,355.00
Silver	69.57	22.59	21.83	19.15	18.29	22.86	23.47
Platinum	61.52	1,683.53	1,655.78	1,565.36	1,589.33	1,668.00	1,705.00
Palladium	63.62	578.38	563.95	493.58	482.89	583.00	592.00
Active Month Future	COMEX GLD	COMEX SLV	NYMEX PAL	NYMEX PLAT	DGCX GLD	TOCOM GLD	CBOT GLD
	Dec'10	Dec'10	Jan'11	Jan'11	Dec'10	Aug'11	Dec'10
Settlement	1,347.50	23.0800	584.30	1,690.80	1,348.00	3,547.00	1,348.10
Open Interest	633,064	155,385	24,908	39,179	2,110	104,107	2,303
Change in Open Interest	-12,548	-2,660	-233	-717	-	1,525	57

Date: 11 October 2010

Sources: Standard Bank; LME; Bloomberg

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