

FICC Research

Commodities: Daily

Focus: Gold outpaces its long-term drivers



6 October 2010

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

Leon Westgate*
Leon.Westgate@standardbank.com

Focus: Gold continues its spectacular rally. Indications from the Bank of Japan that it would implement further quantitative easing are assisting gold's ascendancy. However, gold is now outpacing its long-term drivers.

- The base metals shifted up a gear in Tuesday, with the initial bout of short covering and triggering of stops, giving way to fresh buying activity during the afternoon. A great deal of the recent strength in prices has been dollar related, however, better than expected economic data, in Tuesday's case the US September ISM figures, have also lent support to the complex, as have stronger equity markets.
- We look specifically at the strong ZAR which is now well below the R7/USD level. The ZAR plays a very important role in the revenue structure of South African PGM producers. While platinum in ZAR has risen in recent days, the platinum price in ZAR lags that off the platinum price in USD.
- Consensus expectations are for DOE crude oil inventories to come in at +413K bbl, well below yesterday's API figures which showed a bearish 4,442K gain. Gasoline inventories are expected to show a 250K bbl draw, while distillate stocks are expected to decline by 1,000 K bbl.

Commodity price data (5 October 2010)

Base metals LME 3-month									
	Open	Close	High	Low	Daily change	Change (%)	Cash Settle	Change in cash settle	Cash – 3m
Aluminium	2,360	2,380	2,401	2,381	17	0.72%	2,335.00	3	-33.25
Copper	8,135	8,177	8,326	8,210	111	1.38%	8,125.00	40	-16.75
Lead	2,306	2,312	2,360	2,322	34	1.49%	2,275.00	10	-27.75
Nickel	24,360	24,720	25,200	24,700	560	2.32%	24,260.00	425	-14.00
Tin	25,700	25,925	26,790	26,100	500	1.98%	25,750.00	820	0.00
Zinc	2,270	2,313	2,353	2,305	82	3.68%	2,260.00	55	-30.25
Energy									
	Open	Close	High	Low	day/day	Change (%)			
ICE Brent	84.78	85.15	85.23	84.53	0.31	0.36%			
NYMEX WTI	82.60	83.21	83.24	82.43	0.39	0.47%			
ICE Gasoil	724.00	729.00	729.75	723.00	5.25	0.72%			
API2 Q3'10	95.80	96.40	-	-	0.60	0.62%			
EUA Dec10	15.26	15.50	-	-	0.24	1.57%			
Precious metals									
	AM Fix	PM Fix	High bid	Low offer	Closing bid	Change (d/d)	EFPs		
Gold	1,325.75	1,330.50	1,341.30	1,312.75	1,339.00	24.00	0.8/1.2		
Silver	-	23.01	22.74	21.82	22.71	0.78	1.0/3.0		
Platinum	1,681.00	1,689.00	1,698.00	1,668.00	1,698.00	31.00	3.0/5.0		
Palladium	566.00	569.00	576.00	558.00	575.00	16.00	0.0/2.0		

Sources: Standard Bank; LME; BBG

Please refer to the disclaimer at the end of this document.

Focus: Gold outpaces its long-term drivers

Gold continues its spectacular rally. Indications from the Bank of Japan that it would implement further quantitative easing are assisting gold's ascendancy. However, gold is now outpacing its long-term drivers.

For some time now, we have said that the long-term causal fundamental drivers for investment demand in gold is *liquidity* (not necessarily inflation) and *long-term real interest rates*. At the moment, both support a higher gold price into next year (see *Commodities Insight* dated 11 Aug 2010).

The BoJ's announcement yesterday spells a higher gold price. Gold's relationship with liquidity is confirmed visually (see graph) as well as empirically. We measure global liquidity as the US Fed balance sheet plus global foreign reserves holdings excluding gold. YTD, our measure of global liquidity is up 10%. The gold price is up 18% YTD.

Following gold's latest rally there is growing divergence between the gold price and global liquidity — the gold price has been rising much faster than liquidity. This is not inconsistent with past behaviour. There are many short-term drivers of gold (such as credit risk, equities and currency moves) which account for these short-term price movements. Furthermore, the difference between liquidity and the gold price is not at an extreme level yet, and we can therefore not conclude that gold is overbought. But we are certainly more cautious with gold at these levels. Speculative length is building, and scrap gold continues to come to the market.

As mentioned in *Commodities Daily* dated 4 Oct 2010, we would

Base metals

The base metals shifted up a gear in Tuesday, with the initial bout of short covering and triggering of stops, giving way to fresh buying activity during the afternoon. A great deal of the recent strength in prices has been dollar related, however, better than expected economic data, in Tuesday's case the US September ISM figures, have also lent support to the complex, as have stronger equity markets.

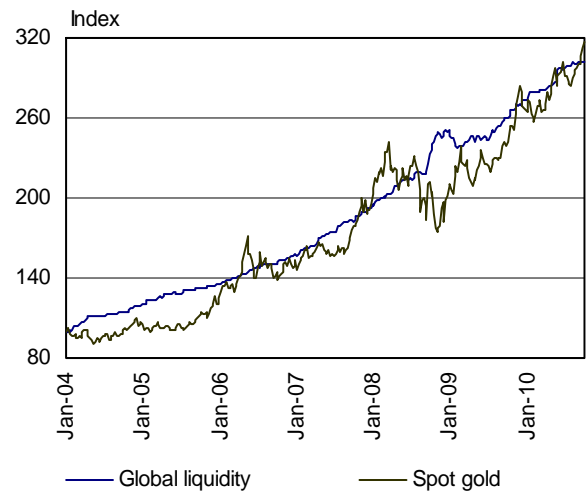
This morning has seen the metals continue to push higher initially, though momentum has faded a little heading into the afternoon. The dollar has continued to weaken, lending background support to the complex, however the strength of the US equity markets this afternoon will likely also impact on price direction.

Although there is likely to be a bit of volatility later this week, particularly as we approach Friday's US NFP figures, the more interesting question is what the Chinese will make of the price action after their week-long holiday, particularly with much of the industry tied up with LME week meetings and activities. Next week therefore has the potential for turning into a bit of a rollercoaster ride for the base metals.

Tin surged to a new record on Tuesday, with the metal subsequently breaking that record this morning as prices surged above \$26,700. On-warrant inventories are continuing to come under pressure, falling 280 mt this morning after a 325 mt increase in cancelled warrants in Johor. With little sign that supply will increase dramatically over the short term, tin looks set to have a very strong quarter ahead.

Pan Pacific Copper has announced plans to reduce its output of refined copper by 5.1% in the second half of its fiscal year (to March 31st) compared with the same period last year. Output is expected to fall to 271.1Kt in the next 6 months, compared to 285.7 kt.

Gold vs. global liquidity



Source: Standard Bank

not be surprised to see a pull-back in gold.

Looking into 2011, we believe that global liquidity will keep rising as emerging markets specifically further expand their foreign reserve holdings. However, we expect it to slow in 2011 and 2012 — to only 8% and 5% respectively. This growth in liquidity should support gold.

By Walter de Wet

By Leon Westgate

Precious metals

Financial markets are bullish. This is spilling over into precious metals. However, our views on the precious metals basket remains unchanged *despite* gold hitting new highs this morning.

Gold continues to climb. Indications that the Bank of Japan will join the Fed in additional quantitative easing have set the metal alight. Our bullish view on gold into 2011 remains but after the performance since last week, combined with what we see in the physical market, dampens our short-term optimism.

Gold support is at \$1,320 and \$1,302. Resistance is at \$1,350 and \$1,360.

EM currencies continue to appreciate against most G10 currencies. We continue to view demand for EM assets as indication that other high beta asset, such as commodities, would remain well bid. We look specifically at the strong ZAR which is now well below the ZAR7/\$ level. The ZAR plays a very important role in the revenue structure of South African PGM producers. While platinum in ZAR has risen in recent days, it lags well behind the platinum price in USD. As a result, not much cost-pressure has been released on some platinum mines in South Africa. Our target for platinum remains \$1,800 and \$650 for palladium.

Platinum support is at \$1,670 and \$1,650. Resistance is at \$1,707 and \$1,725. Palladium support is at \$565 and resistance is at \$596.

Fundamentally, we remain bullish on copper. Combined with our view on gold, we believe that a pull-back in silver is likely to be short-lived. Silver support is at \$22.15 and \$24.50. Resistance is at \$23.20 and \$23.60.

By Walter de Wet

Energy

Crude oil rallied very strongly on Tuesday as further dollar weakness and increased risk appetite combined to see prices for front month WTI retest the early-August highs. WTI has continued to push higher during London trade, with momentum buying briefly pushing prices above \$83/bbl for the first time since early May. \$83 is emerging a key level and will likely be a bit of a battleground this afternoon.

After a slow start, the dollar has started to weaken again heading into the afternoon. In spite of the weaker dollar however, prices have drifted lower hading into the afternoon, with the dollar effect fading somewhat and not driving prices as much as it has done in previous days.

Bar extremely bearish DOE inventory figures this afternoon, we do not foresee a significant downside risk in outright prices for the near term. The market seems convinced that the Fed will implement a fresh round of QE, while better than expected economic data is also boosting sentiment.

Consensus expectations are for DOE crude oil inventories to come in at +413K bbl, well below yesterday's API figures which showed a bearish 4,442K gain. Gasoline inventories are expected to show a 250K bbl draw, while distillate stocks are expected to decline by 1,000 K bbl.

By Leon Westgate

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	4,344,500	4,348,850	1,300	5,650	-4,350	-284,400	233,950	5.38	171,834
Copper	374,100	374,450	950	1,300	-350	-128,225	17,050	4.56	75,546
Lead	197,775	197,850	225	300	-75	51,275	8,875	4.49	31,969
Nickel	123,270	123,540	0	270	-270	-34,740	4,284	3.48	24,689
Tin	12,545	12,540	55	50	5	-14,220	450	3.59	5,512
Zinc	614,100	614,825	0	725	-725	126,050	46,325	7.54	44,196

Shanghai 3-month forward prices

COMEX active month future prices

Metal	Open	Last	1d Change	Open	Close	Change	Change (%)
Aluminium	-	-	-	Ali Dec'10	-	-	-
Copper	-	-	-	Cu Dec'10	373	378.55	5.90
Zinc	-	-	-				1.58%

ZAR metal prices (5 October 2010)

	Aluminium	Copper	Lead	Nickel	Tin	Zinc	ZAR/USD fix
Cash	16,245	56,526	15,827	168,777	179,143	15,723	6.9570
3-month	16,802	57,726	16,322	174,511	183,018	16,329	7.0595

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)	93.56	-0.35	94.41	-0.22	95.12	-0.04	96.54	-0.12	-	-
Gasoil 0.1% Rdam (\$/mt)	729.00	5.25	727.75	5.50	729.25	6.00	738.00	6.50		
NWE CIF jet (\$/mt)	761.21	-0.24	766.39	-0.49	772.68	0.52	783.22	0.58		
Singapore Kero (\$/bbl)	94.75	-0.38	95.16	-0.27	95.92	-0.09	97.52	-0.19		
3.5% Rdam barges (\$/mt)	458.75	2.00	460.75	2.00	462.75	2.00	471.44	1.98		
1% Fuel Oil FOB (\$/mt)	473.50	2.50	480.00	3.00	484.75	2.50	497.69	3.23		
Sing FO 380 Cargo (\$/mt)	100.15	-	100.15	-	100.15	-	100.15	-		
Sing FO180 Cargo (\$/mt)	481.00	1.50	484.75	1.50	487.75	1.25	495.94	1.23		
Thermal coal	Q4-10		Q1-11		Q2-11		Cal 11		Cal 12	
API2 (CIF ARA)	96.40	0.60	97.50	0.50	98.90	0.60	99.60	0.60	106.70	0.60
API4 (FOB RBCT)	90.30	0.90	92.70	0.60	94.10	0.80	94.80	0.80	100.50	0.60

Precious metals

Forwards (%)	1-month	2-month	3-month	6-month	12-month		
Gold	0.37000	0.39833	0.41333	0.47167	0.51000		
Silver	0.58000	0.58000	0.58833	0.60500	0.61333		
USD Libor	0.25688	0.27359	0.29000	0.46188	0.77675		
Technical Indicators	30-day RSI	10-day MA	20-day MA	100-day MA	200-day MA	Support	Resistance
Gold	73.63	1,313.36	1,290.59	1,231.12	1,181.38	1,326.00	1,355.00
Silver	74.95	21.93	21.22	18.94	18.18	22.25	23.34
Platinum	68.40	1,660.92	1,628.92	1,558.20	1,585.34	1,678.00	1,716.00
Palladium	64.62	566.38	553.08	487.57	479.44	568.00	591.00
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	Oct'10	Aug'11	Dec'10
Settlement	1,349.70	23.0350	587.00	1,700.70	1,341.00	3,611.00	1,348.90
Open Interest	613,188	153,761	24,172	38,244	2,563	108,731	2,347
Change in Open Interest	-142	-125	278	131	-418	1,163	65

Date: 5 October 2010

Sources: Standard Bank; LME; Bloomberg

Disclaimer

Certification

The analyst(s) who prepared this research report (denoted by an asterisk*) hereby certifies(y) that: (i) all of the views and opinions expressed in this research report accurately reflect the research analyst's(s') personal views about the subject investment(s) and issuer(s) and (ii) no part of the analyst's(s') compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed by the analyst(s) in this research report.

Conflict of Interest

It is the policy of The Standard Bank Group Limited and its worldwide affiliates and subsidiaries (together the "Standard Bank Group") that research analysts may not be involved in activities in a way that suggests that he or she is representing the interests of any member of the Standard Bank Group or its clients if this is reasonably likely to appear to be inconsistent with providing independent investment research. In addition research analysts' reporting lines are structured so as to avoid any conflict of interests. For example, research analysts cannot be subject to the supervision or control of anyone in the Standard Bank Group's investment banking or sales and trading departments. However, such sales and trading departments may trade, as principal, on the basis of the research analyst's published research. Therefore, the proprietary interests of those sales and trading departments may conflict with your interests. **Please note that one or more of the analysts that prepared this report sit on a sales and trading desk of the Standard Bank Group.**

Legal Entities:

To U. S. Residents

Standard New York Securities, Inc. is registered with the Securities and Exchange Commission as a broker-dealer and is also a member of the FINRA and SIPC. Standard Americas, Inc is registered as a commodity trading advisor and a commodity pool operator with the CFTC and is also a member of the NFA. Both are affiliates of Standard Bank Plc and Standard Bank of South Africa. Standard New York Securities, Inc is responsible for the dissemination of this research report in the United States. Any recipient of this research in the United States wishing to effect a transaction in any security mentioned herein should do so by contacting Standard New York Securities, Inc.

To South African Residents

The Standard Bank of South Africa Limited (Reg.No.1962/000738/06) is regulated by the South African Reserve Bank and is an Authorised Financial Services Provider.

To U.K. Residents

Standard Bank Plc is authorised and regulated by the Financial Services Authority (register number 124823) and is an affiliate of Standard Bank of South Africa. The information contained herein does not apply to, and should not be relied upon by, retail customers.

General

This research report is based on information from sources that Standard Bank Group believes to be reliable. Whilst every care has been taken in preparing this document, no research analyst or member of the Standard Bank Group gives any representation, warranty or undertaking and accepts no responsibility or liability as to the accuracy or completeness of the information set out in this document (except with respect to any disclosures relative to members of the Standard Bank Group and the research analyst's involvement with any issuer referred to above).

All views, opinions and estimates contained in this document may be changed after publication at any time without notice. Past performance is not indicative of future results. The investments and strategies discussed here may not be suitable for all investors or any particular class of investors; if you have any doubts you should consult your investment advisor. The investments discussed may fluctuate in price or value.

Changes in rates of exchange may have an adverse effect on the value of investments. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Members of Standard Bank Group may act as placement agent, advisor or lender, make a market in, or may have been a manager or a co-manager of, the most recent public offering in respect of any investments or issuers referenced in this report. Members of the Standard Bank Group and/or their respective directors and employees may own the investments of any of the issuers discussed herein and may sell them to or buy them from customers on a principal basis. This report is intended solely for clients and prospective clients of members of the Standard Bank Group and is not intended for, and may not be relied on by, retail customers or persons to whom this report may not be provided by law. This report is for information purposes only and may not be reproduced or distributed to any other person without the prior consent of a member of the Standard Bank Group. Unauthorised use or disclosure of this document is strictly prohibited. By accepting this document, you agree to be bound by the foregoing limitations. Copyright 2010 Standard Bank Group. All rights reserved.