Chinese New Year—what could we expect…

China marks the beginning of the lunar calendar with a statutory 7-day holiday beginning on Chinese New Years Eve (today, Feb 4th) as the year of the Pig is welcomed in.

Given historically volatile moves around (not necessary during.…) this period and to test the thinking of seasonally strong buying pressure in the lead up to CNY, the subsequent pages looks at some metals pricing & performances and stock & positioning patterns.

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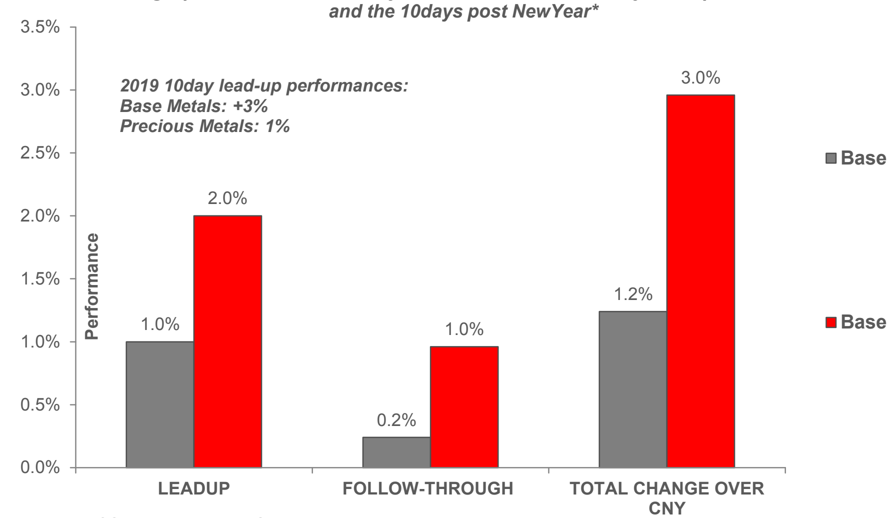
Base & Precious Metals over the Chinese New Year: buy the runup, exit post-event?

*Average performances over the years 2009-2018 in the 10day lead-up to New Year and the 10days post NewYear**



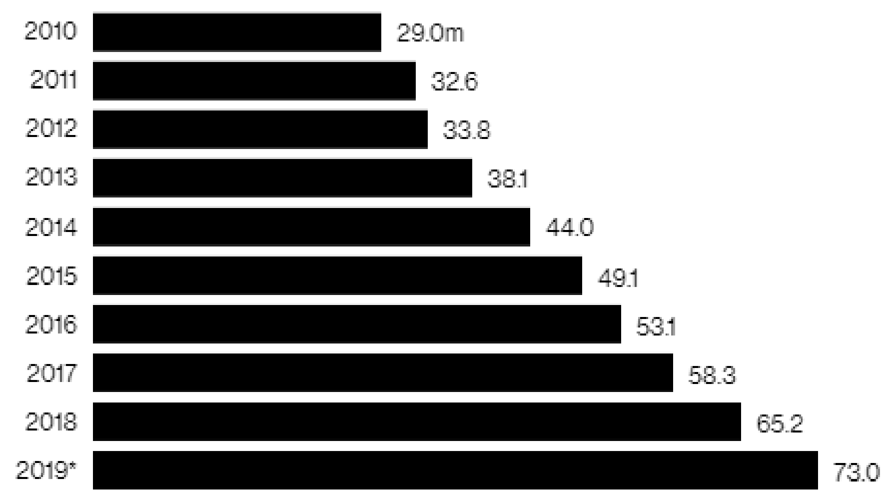
Precious = BCOM Precious Metals Spot Index
Base = BCOM INdustrial Metals Spot Index

*Date set available

Source: Scotiabank Commodities Strategy, Bloomberg

China readies itself for the largest human migration.

No. of Chinese air passengers during New Year holidays (mn) vs the 54mn of Americans journeying over Thanksgiving



Source: Civil Aviation Administration of China (*forecast), Bloomberg, Scotiabank Commodities Strategy

1. Pricing: Base & Precious Metals

The traditional thinking is metals remain bid in the lead up to CNY (and come under pressure after) given seasonal consumer restocking habits. Very broadly, base and precious metals are currently performing according to this belief, as they have both put in positive returns YTD (Precious +2.2% and Base +8%) AND were buoyed in the 10day run-up period into CNY as tested in the graph 1 below. Graph 2 highlights and quantifies the historical performances of Copper and jewelry sensitive Gold & Platinum both in the lead up (10days before) and the post Chinese New year:

Copper:

⇒ over the past 18years, Copper is on average the best performer in the 10day leadup to Chinese New Year, posting almost 4% gains. Most of these gains were printed in the boom growth years (2007-2010). The average of Copper over the most recent 4 years (the new lower-growth regime) is a cooler +1.8%. In the 2019 run-up to Feb 5th,Copper has broadly matched this, up 1.5%.

Gold, Platinum & Palladium:

Historically, any major Chinese (or Indian) festivals or holidays is associated with increased metals consumption in the lead-up to event, (increased luxury-good-related platinum and gold jewelry demand) as well as an increase in speculative activity as positions are shaved down.

In the lead up to CNY this year, the premium for physical Au9999 Gold traded up to around $14/oz (from $7/oz in mid Nov '18). A mixture of 1). manufacturers restocking inventory for festival sales (its expected they will unload any surplus inventory after Feb 11th, thus pressuring the premium lower) AND 2). the typical lack of availability of import quotas in the beginning of the calendar year, and FX liquidity constraints, contributed to the premium move higher. Overall,

⇒ Platinum posts the most consistent gains both in the lead up and follow-through after CNY, in total rallying +3.3%. Platinum entered this CNY largely flat-lower (in the 10day lead-up period), arguing from this perspective that a small bullish window is still open

⇒ Gold posts only mild gains in the 10day lead up to CNY—on average +1.5%, which mirrors the current 10-day lead up performance.

⇒ Palladium: given the recent liquidity gaps in both front and forward curve, the market perhaps gets to test just how much of the driver the Chinese auto-related bid has been behind the recent structural tightness.

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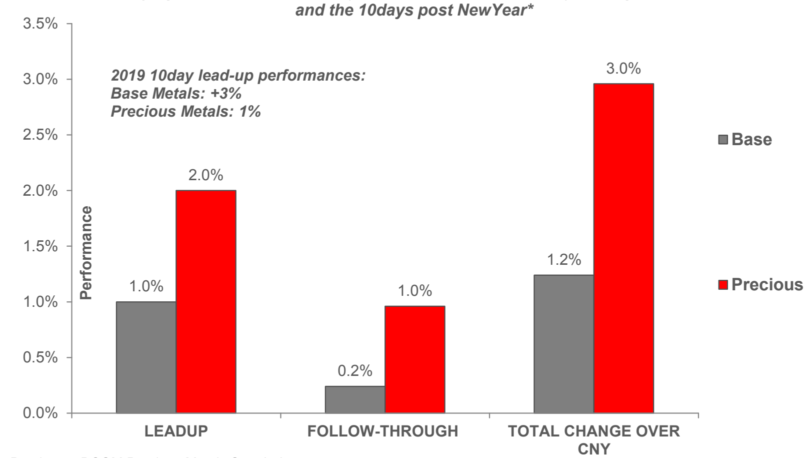

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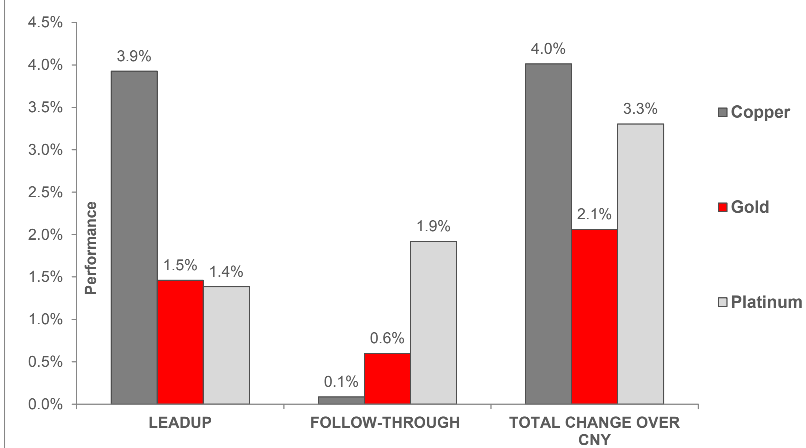
Copper, Gold & Platinum over the Chinese New Year

*Average performances over the years 2001-2018 in the 10day lead-up to New Year and the 10days post NewYear**



Source: Scotiabank Commodities Strategy, Bloomberg

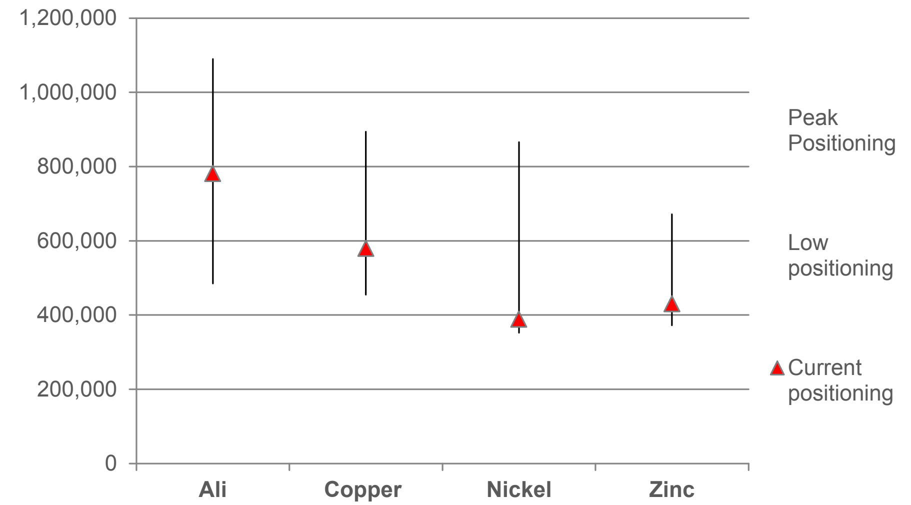
2. Base Metals Positioning & trading liquidity, and inventory changes

Given both the increasing importance of Chinese (SHFE) paper participants in base metals, the propensity for speculators to derisk ahead of the holiday season and their consumption trends in almost all metals, its worthwhile to provide an overview of where positioning and stocks stand, and the historical movement post CNY:

SHFE Positioning:

- Most accounts always tidy up positioning ahead of the CNY and especially since the exchange/SHFE increases the initial margin (effective Feb 1st it increased by 2% and reverts back on reopening on Feb 11th).
- The most illiquid trading days are likely tomorrow & Wednesday (as China, HK, Singapore, Korea and Malaysia are all shut for these 2 days).
- Besides Ali (in which Chinese aggregate positioning is sitting at a rather neutral 2 year average), most base metals are very underweight, especially Zinc and Nickel as the graph depicts.
- That reinforces the earlier notion that under owned metals risk outperforming (Nickel & Zinc are already up 24 % and 13% respectively). This YTD move was predominantly a close out of SHFE short positioning (Agg OI down with prices up) which was accentuated by stock cancellations and a micro story (In Nickels case, Vale and the *threat* of Nickel production ratcheting up)

Chinese Base Metals tactical positioning: except for ali, very light heading into CNY



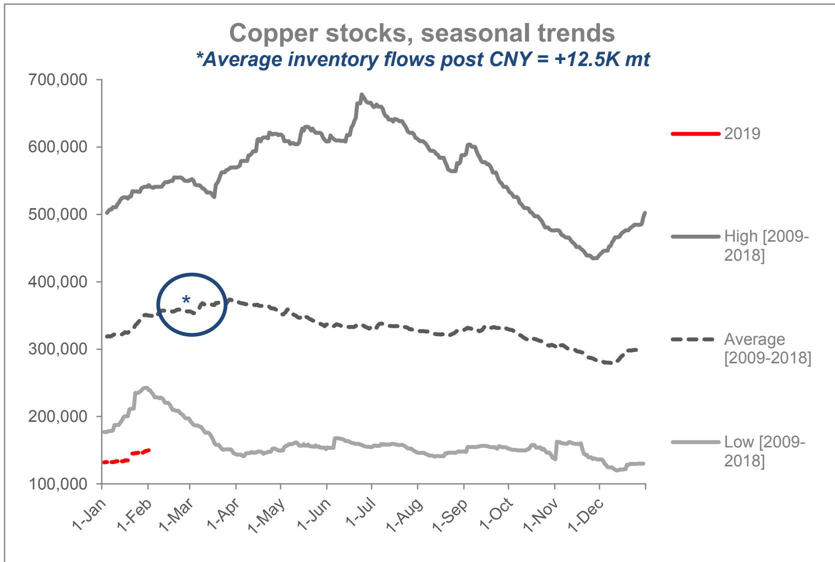
*High - Low positioning is 2 year Aggregate Open Interest range

Source: SHFE, Bloomberg, ScotiaBank Commodities Strategy

Stocks*

- Lower inventory levels across the board is well cited and known. However relative to previous CNY periods, Copper and Zinc are entering this festival season with the lowest buffer (below 10year average lows).
- Post CNY, historically Copper sees steady inflows (on average around 12% of current positioning, or ~13K mt) and Ali sees around 26K mt of inflows.
- However Zinc and Lead are susceptible to further outflows post CNY, creating some spread tightening risk

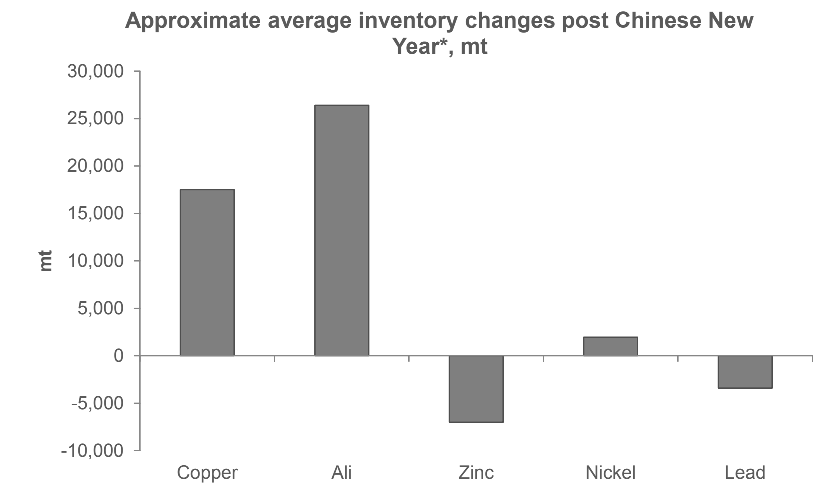
*LME Stocks taken as a proxy for global stocks



Source: Scotiabank Commodities Strategy, Bloomberg

	Current Stocks, mt	Above / below 10year low	Average Inventory changes post CNY*, mt	Potential in/out flow (% of current positioning)
Copper	150,000	Below	17,500	12%
Ali	1,300,000	Above	26,400	2%
Zinc	113,000	Below	-7000	-6%
Nickel	201,000	Above	1950	1%
Lead	72,000	Above	-3400	-5%

Source: Scotiabank Commodities Strategy, LME



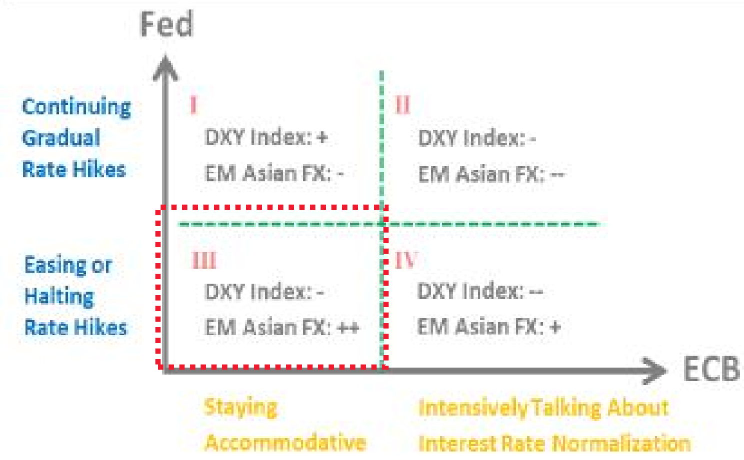
** Given CNY usually falls within the first 6weeks of Q1, the measured average change in inventory is the 6week period from mid Feb to end of March, from 2009-2018*

Source: Scotiabank Commodities Strategy, Bloomberg

FX, policy responses and trade war

- This is the first CNY, that table dinner discussions could include US / Trump & trade policies. That's important in that sentiment can be further shaped
- The PBOC remains on high alert mostly before the holidays as the onslaught of cash withdrawals and slowdown in business activity puts pressure on liquidity generally.
- Confidence in both the local economy but also across the region and (and related to) the ongoing trade talks is quite bleak. The much softer data—reflecting the end of pre-tariffs loading which occurred mostly in Nov last year—has resulted in a mix of piecemeal stimulus policies and responses.
- With high level trade talks on hold (until Mnuchin and Lighthizer travel to China for the next round of talks after mid-February), and a convincing dovish tilt across DM central bank policies given the recent global (not US) growth developments, EM and EMFX have outperformed.
- Our Asian FX strategists** do expect a US / China trade deal to materialize ontop of structural drivers (changes in global growth & inflation andCB policies that is supportive Asian EM currencies—box III in graph). They look to target 6.60 in USD/CNH, and while Base metals (thanks in part to Nickel) has internalized this view quicker almost trading up to 120 (BCOM Industrial Index), a simple regression using correlations before the Vale disaster, implies that BCOM could rally to 126.50 (a further 5.4%) ON further CNH strength toward 6.60.
- Note, China's onshore markets is closed this week for the holiday, but the offshore CNH is open and expected to be on autopilot perhaps track the EUR more closely

Impact of Fed and ECB's Stance on DXY Index and EM Asian Currencies (w/o other risks)



Source: Scotiabank FICC Strategy

Base Metals vs CNH

Source: Scotiabank Commodities Strategy, Bloomberg
CNH Curncy (Offshore Deliverable CNY) base vs cnh Weekly 04FEB2017-04FEB2019 Copyright© 2019 Bloomberg Finance L.P. 04-Feb-2019 15:26:12