Unprecedented, Unexpected and Unprepared: Analyzing The Covid-19 Impact on Metal Markets

Nicky Shiels, Metals Strategist

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Today's Agenda

Macro Backdrop:
• Unprecedented health crisis quickly morphed into an economic one

Outlook for Gold:
• More bullish trajectory than the 2009-2012 Cycle

Outlook for Silver:
• The ‘tagalong’ awaiting a growth inflection point and/or catalyst

Outlook for PGMs:
• Longer term is clearer than the short term – a new cycle, an era of higher (PGM) prices

Outlook for Copper:
• A 2nd frustrating year for bulls -- new surplus with a U-Shaped recovery; upside bias on macro factors in s/t, fundamentally stronger in l/t

Outlook for Aluminum
• Hard-hit by demand destruction to transportation and now awaiting supply response
Macro Summary: Navigating Various Crises in a Ever-Faster News, Data & Policy Cycle

- A deflationary demand crisis, a supply chain crisis, a labor market crisis and an energy price crisis.
- From Trade to COVID-19: similar phenomenon (borders-up protectionism)
- Policy action: ‘too much’ (cascading and extended lockdowns) because ‘too late’
- Larger tail risks: “V-U-or L”, but also “↓” or “Nike Swoosh” recoveries?
Macro Summary: Unprecedented monetary & fiscal policy

- Both have started earlier and ramped up faster than anytime in history.
- Swift pre-emptive totalitarian action by governments, creates an ugly precedent for permanently bigger government, surveillance states.
- Correlated but not coordinated policy response; 750bps of global rate cuts (620 bps driven by G-10 CBs) and almost $4 tn has been pledged by COVID-19 affected countries!

Covid-19 Affected Countries Monetary & Fiscal Policy Response Timeline

Note: Fiscal policy numbers are converted using exchange rates on the day of announced policy. Easing equates to traditional rate cuts and not repo operations.

Source: Scotiabank Commodity (Metals) Strategy
Gold: Navigating the Deflationary-Inflationary Signals

- Gold has found it post crisis floor.
- Large dislocations between paper/physical after some hefty margin related selling.
- Fast money positioning is a lot cleaner.
- Max macro fear has dialed back from extreme levels.
- New super bullish structural themes have emerged faster than anticipated (bigger gov, unlimited QE, negative interest rates, unlimited deficits, Fed buying junk bonds, MMT-like policies).
**Gold: More Bullish Trajectory Than The 2009-2012 Cycle**

- Macroeconomic backdrop of lower & slower growth profile and unprecedented stimulus, never been better.

- BUT some short-term headwinds (liquidity, subdued Asian physical demand, inactive bullish CB activity).

- Large scale inflow from Western retail & institutional should offset weaker physical demand and the short-term headwinds.

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**Fed Balance Sheet vs Gold**
- Feds Balance Sheet (LS)
- Gold price (RS)

**Global Central Bank Balance Sheet vs Gold**
- The big 4 Bal Sheet (Fed+ECB+BOJ+BOE), converted into US$ (LS)
- Global ETF Gold Holdings (oz) (RS)

Scotiabank Commodity (Metals) Strategy, Bloomberg

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GLOBAL BANKING AND MARKETS
Gold: More Bullish Trajectory Than The 2009-2012 Cycle

Gold Trades at a Fear Premium of $120

Source: Scotiabank Commodity Strategy (Metals) Calculations, Bloomberg
Note: Note: Premium/discount is estimated using a multi variate OLS robust regression model with a 10-year rolling window approach. Our features include the DXY, USDJPY, USDEUR, USDGBP, and the US 10-year real yield derived off the US 10-year treasury and 10-year breakeven. Our model explains 95% of the variation in gold since 1999. A positive (negative) number indicates Gold is trading at premium (discount) versus where our current endogenous variables are indicating.
Silver: The ‘tagalong’ awaiting a growth inflection point or catalyst

- Will begrudgingly tag behind any Gold rise and should continue to underperform in the near-term until the growth inflection point.

- Fresh catalyst emerging with 1/3rd of global supply down, but fundamentally requires years of deficits to substantially draw down inventories.

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**Exchange Silver inventories & forward rates**

- Extremely well supplied...

- COMEX Warehouse Inventories, mn oz
- SHFE warehouse inventories, mn oz

- Exchange inventories at record highs (~400m oz of Silver), ~35% larger than the previous peak in 1993

- Leverage tightness - lease rates spike

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Source: Scotiabank Commodities Strategy, Bloomberg

COMEX SILV Index (Comex Silver Inventory Date) comex shfe silv stocks2 Monthly G5 Copyright 2020 Bloomberg L.P. 11-Apr-2020 13:31:37
Silver: The ‘tagalong’ awaiting a growth inflection point or catalyst

- Fundamentally oversupplied but still attractive as a cheap high beta gold proxy.

- Gold/Silver ratio to remain in a less bullish uptrend as macro markets navigate from late cycle era to recovery period.

- Upside (> $20) dependent on: Gold outperformance, inflation and reflation risks AND fresh real demand drivers in medium term, potentially stemming from known (PVs) and nascent (auto) industries.
(Bullish) longer-term is clearer than the (low conviction) shorter-term.

With major supply disruptions in S.A due to national 5-week lockdown and ongoing logistical and transportation issues more than offsetting the negative demand impact auto plant closures in US, India & Europe.

Historically and relatively tighter metals (Palladium & Rhodium) are to remain super volatile with availability sporadic and tight, while Platinum's surplus is due to narrow.

Platinum should reset higher above $1000; palladium to average $2300+ in 2020.
Copper: A 2nd Frustrating Year for Bulls; New Surplus with a U-shaped recovery

- Demand destruction: falling 5.7% YoY in 2020; surplus of ~540k mt, but incremental & subsequent supply cuts ensure a ‘runaway surplus’ is thwarted, not reversed.
- Downstream indicators in China of copper demand is improving as factories re-open (fabricators are reportedly operating ~80% of usual utilization rates)
- BUT major export headwinds loom large as the ROW has joined the cascading economic and social shutdowns. Some economic numbers confirm a soft ‘v-shaped’
Copper: A 2nd Frustrating Year for Bulls; New Surplus with a U-shaped recovery

- Floors are in after macro uncertainty unwound and risk assets boosted with a possible infrastructure bill(s). Extremely under-positioned.

- The asymmetric response to the fear of demand, over the fear of supply will persist, limiting rallies in s/t

- Some demand will be lost, but most should be delayed until 2H and ‘triggered’ on any major stimulative efforts

- Further announced supply cuts (<2% of global supply) ‘fit the bullish narrative’ but not the dominant driver.
Copper: A 2nd Frustrating Year for Bulls; New Surplus with a U-shaped recovery

- Conviction in short-term remains low as the virus containment remains fluid & headline risk high

- A new surplus but with “U-Shaped” recovery, $4500 - $5100 ($2.05-$2.30/lbs) comfort range with upside bias on macro factors.

- But underpriced below $5000 if outlook is ‘v-shaped’.

- Upside risks include: Weaker USD, Flat-to-lower medium-term supply (grade declines & depletions), structurally higher energy prices, reflation, Chinese or US infrastructure spend
Ali: Hard-hit by Destruction to Transportation; Awaiting Supply Response

- The old slow grind lower accelerated with global national lockdowns and escalating auto closures; demand to drastically reduce by almost 10%.

- Outright prices are falling faster than falling cost of production costs (due to the oil/energy & alumina price collapse).

- Ali balance to post a larger surplus in 2020 closer to 4m mt; prices to average $1500/mt

- With prices through cash costs, ex-Chinese smelter closures and a slower ramp up of Chinese smelter expansions will lower surplus in 2H’2020 and particularly in 2021
Other Base Metals

**ZINC:**
- Bull market period is in the past
- Demand destruction in 2020 and a structural (concentrate) surplus expected to lift exchange stocks over the next few years as it enters renewed & deeper surpluses.
- That’s unless there's a convincing response via the closure of mines (due to inability to sell concentrate at economic terms)

**NICKEL:**
- The multi-year destocking cycle seems to have now convincingly reversed with the impact of COVID-19 on demand and balances, despite the Indonesian export ban.
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