COMMERZBANK

# Commodity Spotlight Precious Metals

19 March 2014

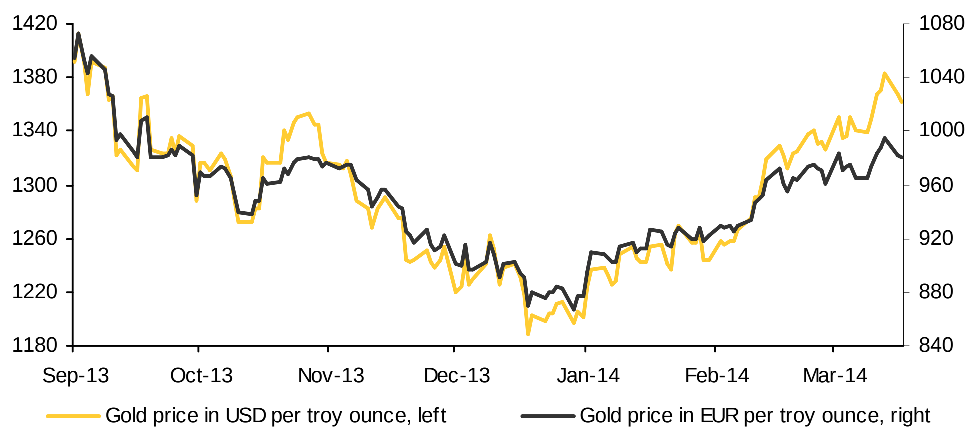
## Gold gets off to surprisingly strong start in 2014

**The gold price climbed to a six-month high of just shy of 1,400 USD a troy ounce in mid-March. The key role in this was played by a trend reversal in ETF sales, though the price rise was also driven in part by speculation. The gold price can thus be expected to fall temporarily again if the support afforded by the Crimean crisis falls away and real interest rates rise again on the back of better US data. Afterwards, the end of ETF selling and robust demand from Asia suggest that the upswing will continue and point to a price level of 1,400 USD a troy ounce by year's end. Boosted by a revival of industrial demand, silver should reduce its under-valuation in relation to gold and rise to 24 USD a troy ounce.**

The gold price continues its recovery since January. The price of gold in US dollar terms has risen by almost 15% since the start of the year and reached a 6-month high in mid March, at 1,392 USD a troy ounce (chart 1). Gold's current strength is not only due to the weak US dollar, which has dropped to its lowest level against the euro since October 2011, but has also climbed by almost 13% in euros since the beginning of the year to its highest level in six months, at 1,000 EUR a troy ounce. Unlike many other market observers, we predicted in our annual outlook that the gold price will rise in the course of 2014, but we were also surprised by the early timing and scale of the upward movement. Special factors such as unrest and currency turmoil in several emerging economies have certainly played a role, as have the recent tensions between Russia and Ukraine and the threat of escalation of the conflict on the Crimea peninsula. This is boosting the demand for gold as a safe haven.

That said, a more important factor for the price rise is the recovery of investment demand in the West. In our annual outlook, we viewed the trend reversal in ETF outflows as the decisive development and this has meanwhile happened. After 24 tons of gold was withdrawn from the ETFs in January, these outflows have since almost entirely reversed (chart 2, page 2). The world's largest gold ETF, SPDR Gold Trust, has meanwhile registered net inflows of 15 tons. The end of ETF sales brings huge relief for the price of gold. A look at the World Gold Council's statistics demonstrates this: ETF outflows of a total 881 tons were the reason why aggregate demand for gold plunged by 15% to 3,756.1 tons last year. Without ETF outflows, gold demand would have reached record level in 2013, as the demand for gold jewellery achieved a 5-year peak at 2,209.5 tons and the demand for coins and bars reached an all-time high at 1,654 tons.

CHART 1: **Gold price posted 6-month high in mid-March**




*Source: Bloomberg, Commerzbank Corporates & Markets*

**Commerzbank Forecasts 2014**

| | Q2 | Q3 | Q4 |
|---|---|---|---|
| **Precious metals** | | | |
| Gold | 1300 | 1350 | 1400 |
| Silver | 21 | 22 | 24 |
| Platinum | 1450 | 1500 | 1600 |
| Palladium | 750 | 775 | 825 |

*USD per troy ounce*

Head of Commodity Research

**Eugen Weinberg**
+49 69 136 43417
eugen.weinberg@commerzbank.com

Analyst

**Barbara Lambrecht**
+49 69 136 22295
barbara.lambrecht@commerzbank.com

Analyst

**Carsten Fritsch**
+49 69 136 21006
carsten.fritsch@commerzbank.com

Analyst

**Michaela Kuhl**
+49 69 136 29363
carsten.fritsch@commerzbank.com

Analyst

**Daniel Briesemann**
+49 69 136 29158
daniel.briesemann@commerzbank.com

*End of high-altitude flight on equity markets has positive impact on gold*

The turnaround in sentiment of ETF investors is attributable to several factors. It was important that the 3-year low of 1,180 USD per troy ounce from late June was maintained at the end of December as this confirmed the bottom for the gold price and dampened the selling pressure. The second main reason is the (temporary) end of the high-altitude flight on equity markets. While the S&P 500 reached a new record high in early March, the index has risen only slightly since the start of the year. The DAX has not been able to regain its peak in January and was actually trading 5% lower in mid March compared to the beginning of the year. Furthermore, equity markets have been highly volatile amid the currency turmoil in the emerging economies and the Crimea crisis. Gold has been experiencing tailwind from the less euphoric and much more volatile trend on equity markets. The shifting from gold to equities, which contributed significantly to ETF outflows last year, has hence abated.

*Fall in real interest rates likewise provided tailwind*

The third major reason is the marked fall in real interest rates since the start of the year. Higher risk aversion on financial markets and weaker economic data from the USA for weather reasons in the main have allowed the yields of 10-year US Treasuries to tumble this year by up to 40 basis points to 2.6%. At the same time, the US inflation rate rose slightly in January. The real interest rate at the end of January was only marginally over 1% and therefore at its lowest since August 2013. That said, real interest rates should rise again once US data improve in the spring after the extremely cold winter has come to an end. Even so, we do not expect a sharp rise in real interest rates like last year, when real interest rates surged from 0% to 1.8% due to rising nominal yields and falling inflation and posed a substantial adverse factor for gold demand in 2013 (chart 3).

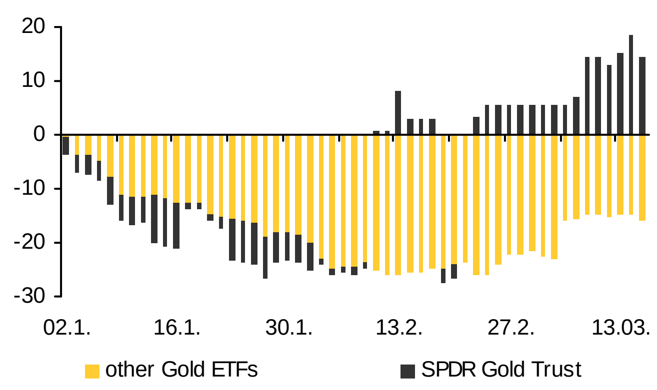
*Speculative investors increasingly betting on rising gold price*

Much brighter sentiment can also be observed among short-term oriented financial investors, who are increasingly betting on a rising gold price. The balance of speculative long and short positions has risen in ten out of eleven weeks since the end of December. In mid-March, net long positions reached their highest level since December 2012, at 106,031 contracts (chart 4, page 4). The equivalent of 294 tons of paper gold thereby flowed into the futures markets on balance between late December and mid March. Speculative financial investors have therefore also contributed significantly to the price rally of past weeks. This also implies correction potential though.

*China likely to consume similar amount of gold in 2014*

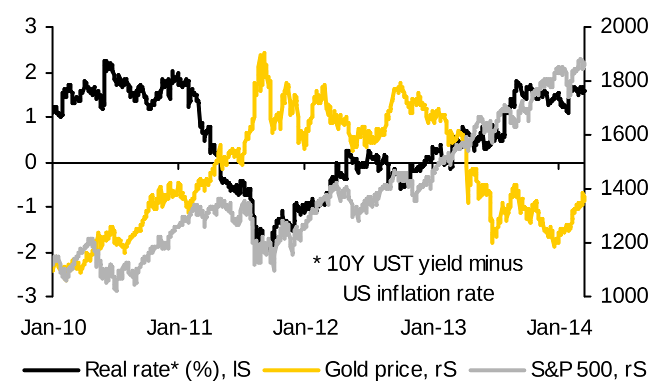
Robust demand from Asia should remain a key supportive factor for gold prices again in 2014. According to the World Gold Council, China and India generated a total demand of over 2,000 tons of gold last year and thus accounted for over 50% of global gold demand. China's demand for gold soared by 32% to 1,066 tons in 2013; India's picked up by 13% to 975 tons. China has consequently overtaken India as the world's biggest consumer. China is unlikely to register another rise in gold demand; its lower economic growth and tighter financing conditions should both dampen demand. Even so, the weakness of the domestic stock market and payment defaults of several investment products of shadow banks should keep gold demand in China at a similarly high level to 2013.

CHART 2: **Gold ETFs don't register net outflows anymore**
Cumulative inflows/outflows since the start of the year in tons




Source: Bloomberg, Commerzbank Corporates & Markets

CHART 3: **Stagnating stock markets and lower real interest rates buoy gold price up of late** (in USD per troy ounce)




Source: Bloomberg, Commerzbank Corporates & Markets

*Possible loosening of import restrictions in India*

Impetus for demand could come from India though, as we could see the gold import restrictions since mid 2013 being loosened at mid year. India's current account deficit has noticeably decreased in the past two quarters and the government had repeatedly cited this as the prerequisite for loosening restrictions. However, the government first wants to see the data for the last quarter of the current fiscal year, which ends on 31 March. Furthermore, elections take place in April and May, which could put a gold-friendlier government in power. The All India Gems & Jewellery Trade Federation demands a reduction of the current 10% import tax and abolition of the 80/20 rule that prescribes that 20% of gold imports cannot be sold domestically, but have to be reserved for export. A loosening of the import restrictions would revive India's gold imports after a 67% plunge in the second half of 2013 compared to the first half, which also contributed to gold's price weakness.

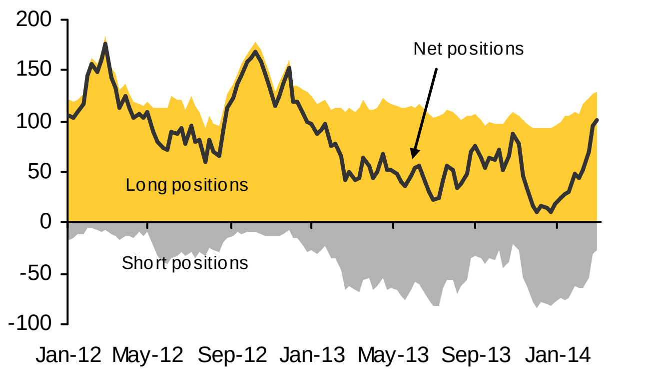
*Gold price likely to come under temporary pressure again*

After the strong and partly speculative rise in the first ten weeks of the current year, the price of gold should come under pressure again temporarily, particularly if the Crimean crisis were to ease, as it played a major part in facilitating the latest price increase. Speculative financial investors would then doubtless start taking profits, especially given that real interest rates should likewise rise again on the back of better US data, thereby also lifting the US dollar. Physical demand in Asia is being noticeably dampened already by the higher price level as the price discount of gold on the Shanghai Gold Exchange to gold traded in London shows. Even so, we do not envisage a sharp price fall or another test of the lows of last year in view of the trend reversal in ETFs and subsequent more robust physical demand again, and see the range between 1,320 and 1,300 USD a troy ounce as an important support.

*But upswing to continue during course of the year*

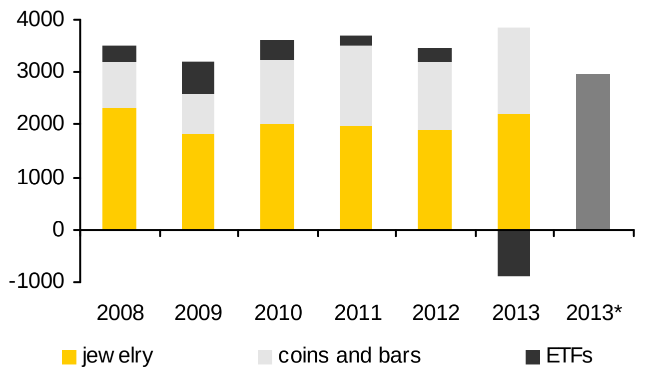
The end of ETF selling combined with robust demand from Asia point to the upswing continuing during the course of the year, especially if gold import restrictions are loosened in India. Inflows to gold ETFs are not even necessary for a higher gold price. Assuming that demand for gold jewellery, coins and bars in 2014 is similarly strong to last year, total gold demand would reach a record level without ETF inflows (chart 5). We therefore expect the gold price to advance to 1,400 USD a troy ounce by the end of the 2014. Significant ETF inflows would imply upside risks for this forecast. On the other hand, the end of Fed asset purchases in the autumn and subsequent speculation on first rate hikes by the US central bank from spring 2015 should weigh on the price and go against a further price rise.

CHART 4: **Speculative market participants increasingly bet on continued gold price increase**
in '000 contracts




*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

CHART 5: **Private gold demand in 2013 excluding ETFs at record level, including ETFs at 4-year low**
in tons per year, *Gold demand 2013 including ETFs




*Source: WGC, Commerzbank Corporates & Markets*

## Silver

*Silver underperformed gold of late*

The price of silver has been pulled along by gold since the start of the year, although its gains are much lower, at 10%. A troy ounce of silver temporarily cost over 22 USD a troy ounce in mid February, which was its highest level since the end of October. Silver has not performed nearly as well as gold since then and this is reflected in the much higher gold/silver ratio. A troy ounce of gold currently equals the value of 65 troy ounces of silver, compared to 60 ounces of silver in mid February (chart 6). Hence, the gold/silver ratio is at the upper end of the trading range of the past ten months.

*Weak industrial demand puts brakes on silver price*

On account of its greater industrial use, silver is more vulnerable to changes in sentiment on the financial markets. Higher risk aversion amid the Crimea crisis and concerns about weaker economic growth in China could explain silver's relative price weakness of late. Furthermore, the payment default on a corporate bond by a Chinese solar company has also caused negative headlines recently. The solar industry accounts for over 10% of total industrial demand for silver. The different perception of gold and silver is also reflected in a comparison of the import statistics from China. While China's gold imports more than doubled last year and reached a record level, at just under 1,160 tons, silver imports decreased in 2013 for the third consecutive year. At 2,566 tons, they were only half as high as in 2010, when they achieved an all-time high of 5,154 tons (chart 13, page 6). In January, silver imports were again 22% down on the year before, suggesting persistently weak industrial demand as silver is predominantly used for industrial purposes in China.

*Turnaround of sentiment among ETF and speculative investors*

The weakness of industrial demand cannot be fully compensated by continued robust investment demand. Like gold, silver has also experienced a turnaround of sentiment of ETF investors in the first quarter of the year. Despite outflows in the first half of January, silver ETFs have registered net inflows of 360 tons since the start of the year. This corresponds to 80% of net inflows of the whole of last year but merely 1% of total silver demand or 2.5% of industrial demand. There has also been a clear improvement in sentiment among more short-term oriented financial investors in the past few weeks, with speculative net long positions increasing to 26,700 contracts at the end of February, the highest level for over a year. Especially short positions were hugely reduced (chart 7). The rise of net long positions since early February corresponds to an equivalent volume of approximately 3,500 tons of silver. That said, this could be unwound again at any time should the price performance not match the expectations of speculative financial investors.

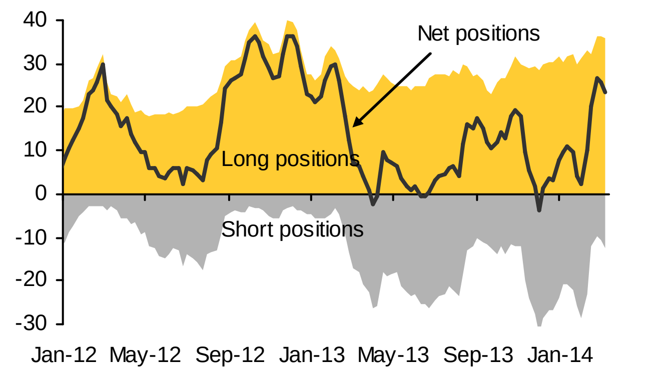
*Silver likely to reduce under-valuation in relation to gold*

We expect the price of silver to reduce its under-valuation in relation to gold in the course of the year, assuming that industrial demand from the industrial countries will revive and no headwind will come from China. Furthermore, silver is relatively cheap compared to gold, which should continue to support investment demand. We see the price of silver at 24 USD a troy ounce at the end of the year.

CHART 6: **Silver price und gold/silver ratio**
Silver price in USD per troy ounce


*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 7: **Speculative financial investors reduce short positions in silver** in '000 contracts




*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

# At a glance

TABLE 1: **Our forecasts**

| | Quarterly average | | | | | | | | | Yearly average | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **17-Mar-14** | **Q1 14** | **Q2 14** | **Q3 14** | **Q4 14** | **Q1 15** | **Q2 15** | **Q3 15** | **Q4 15** | **2013** | **2014** | **2015** |
| Gold | 1367 | 1300 | 1300 | 1350 | 1400 | 1400 | 1350 | 1400 | 1500 | 1413 | 1350 | 1425 |
| Silver | 21.2 | 20.5 | 21.0 | 22.0 | 24.0 | 24.0 | 22.5 | 24.0 | 27.0 | 23.9 | 22.0 | 24.5 |
| Platinum | 1467 | 1430 | 1450 | 1500 | 1600 | 1600 | 1550 | 1600 | 1700 | 1487 | 1500 | 1625 |
| Palladium | 773 | 740 | 750 | 775 | 825 | 825 | 800 | 850 | 900 | 726 | 770 | 840 |

*Quarterly averages, based on spot prices; Source: Bloomberg, Commerzbank Corporates & Markets*

TABLE 2: **ETF holdings (weekly data)**

| | | | Total net change | | | % change | 52 weeks | |
|---|---|---|---|---|---|---|---|---|
| | Date | Holdings | 1 week | 1 month | 1 year | 1 year | High | Low |
| Gold ETFs (in '000 ounces) | 14.03.14 | 56791.2 | 397.0 | 842.9 | -22616.1 | -28.5 | 79407.3 | 55845.8 |
| Silver ETFs (in '000 ounces) | 14.03.14 | 633201.6 | 246.7 | 9409.7 | -430.1 | -0.1 | 645640.6 | 602135.7 |
| Platinum ETFs (in '000 ounces) | 14.03.14 | 2529.0 | 14.5 | 66.8 | 968.3 | 62.0 | 2529.0 | 1546.3 |
| Palladium ETFs (in '000 ounces) | 14.03.14 | 2114.8 | 17.1 | 3.4 | -143.4 | -6.3 | 2282.4 | 2090.7 |

*Source: Bloomberg, Commerzbank Corporates & Markets*

TABLE 3: **Net long positions of money managers (weekly data)**

| | | | Total net change | | | % change | 52 weeks | |
|---|---|---|---|---|---|---|---|---|
| | Date | Level | 1 week | 1 month | 1 year | 1 year | High | Low |
| Gold (in '000 contracts) | 21.01.14 | 30.217 | 1.947 | 19.024 | -67.680 | -69.1 | 97.897 | 9.941 |
| Silver (in '000 contracts) | 21.01.14 | 9.814 | -1.345 | 6.489 | -16.501 | -62.7 | 30.07 | -3.775 |
| Platinum (in '000 contracts) | 21.01.14 | 24.230 | 1.625 | 11.334 | -13.638 | -36.0 | 40.846 | 12.896 |
| Palladium (in '000 contracts) | 21.01.14 | 19.958 | 1.966 | 4.279 | 1.575 | 8.6 | 25.676 | 15.237 |

*Source: Bloomberg, Commerzbank Corporates & Markets*

TABLE 4: **History**

| | Current | % change | | | | History | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | USD per troy ounce | 1 week | 1 month | y-t-d | y-o-y | Q112 | Q212 | Q312 | Q412 | Q113 | Q213 | Q313 | Q413 |
| Gold | 1367 | 0.5 | 2.6 | 12.5 | -15.5 | 1691 | 1612 | 1653 | 1718 | 1632 | 1417 | 1330 | 1291 |
| Silver | 21.2 | -0.2 | -5.2 | 6.9 | -27.9 | 32.7 | 29.5 | 29.9 | 32.6 | 30.1 | 23.2 | 21.5 | 21.2 |
| Platinum | 1467 | -0.5 | 2.4 | 6.4 | -7.7 | 1609 | 1501 | 1500 | 1598 | 1632 | 1467 | 1453 | 1412 |
| Palladium | 773 | -0.7 | 3.6 | 6.5 | 0.0 | 683 | 629 | 613 | 654 | 741 | 714 | 724 | 729 |

*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

TABLE 5: **World Official Gold Holdings (monthly data)**

| Country | tonnes | Country | tonnes |
|---|---|---|---|
| USA | 8,133.5 | Switzerland | 1,040.1 |
| Germany | 3,387.1 | Russia | 1,034.7 (+19.6) |
| IMF | 2,814.0 | Japan | 765.2 |
| Italy | 2,451.8 | Netherlands | 612.5 |
| France | 2,435.4 | India | 557.7 |
| China | 1,054.1 | ECB | 503.2 |

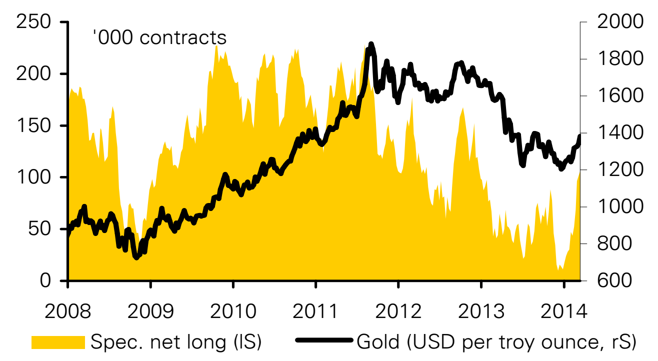
*Source: World Gold Council, Commerzbank Corporates & Markets*

TABLE 6: **Upcoming Events**

| | | |
|---|---|---|
| 1 April | USA | Vehicle sales, March |
| 3 April | EUR | ECB meeting and press conference |
| 4 April | USA | Employment report, March |
| 9 April | USA | Minutes of 18/19 March FOMC meeting |
| 16 April | CHN | GDP, Q1 |
| 17 April | EUR | EU new car registrations, March |
| 29/30 April | USA | FOMC meeting |

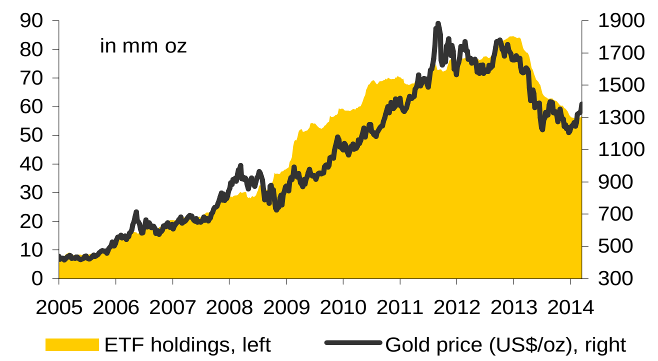
*Source: Fed, ECB, Bloomberg, Commerzbank Corporates & Markets*

CHART 8: **Net long positions of money managers (Gold)**



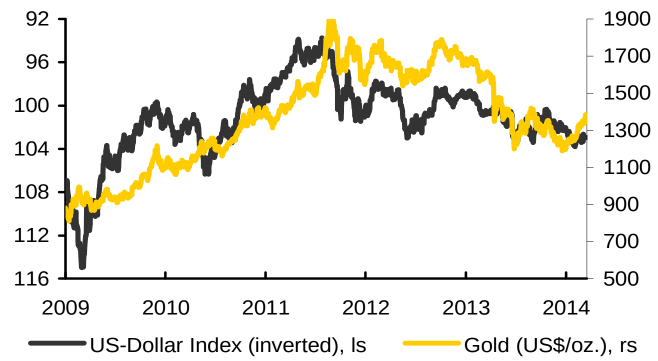

*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

CHART 9: **Gold: ETF holdings**



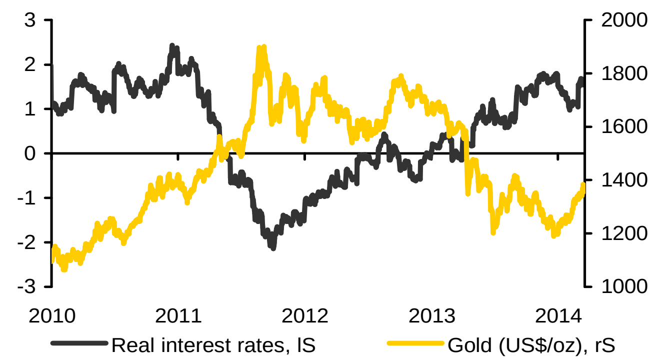

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 10: **Gold versus US dollar**



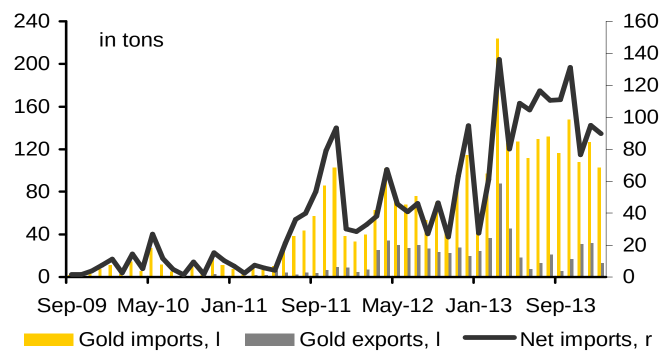

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 11: **US real interest rates versus gold**



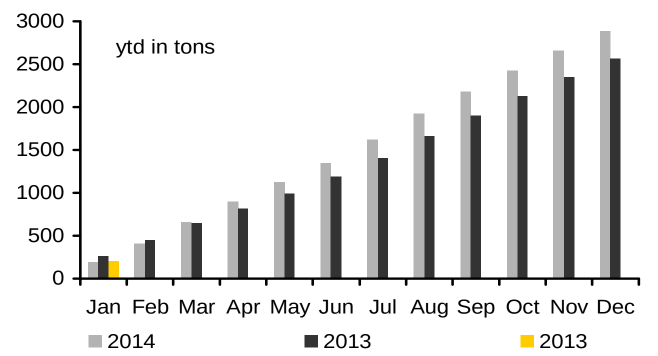

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 12: **Chinese net gold imports via Hong Kong**



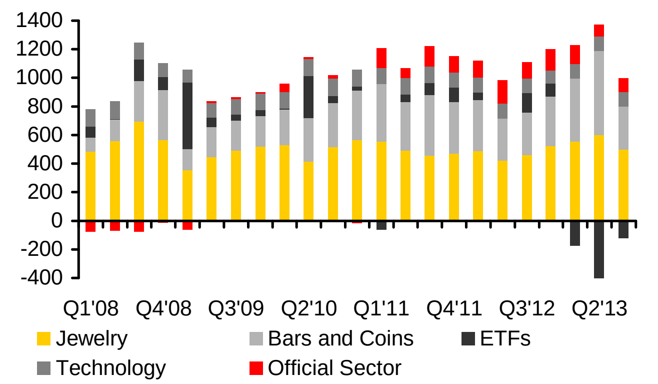

*Source: Statistics Department of HK, Bloomberg, Commerzb. Corp. & Markets*

CHART 13: **Chinese silver imports**



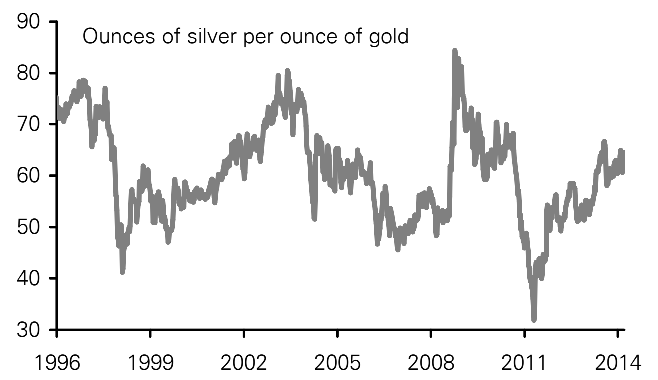

*Source: Chinese Customs Authority, Commerzbank Corporates & Markets*

CHART 14: **Gold demand per quarter in tons**



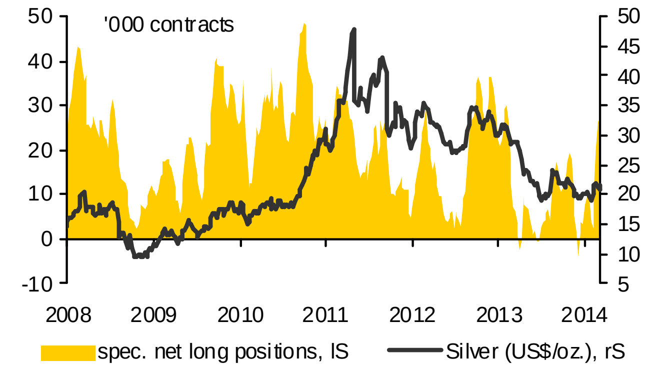

*Source: WGC, Commerzbank Corporates & Markets*

CHART 15: **Gold/Silver ratio**



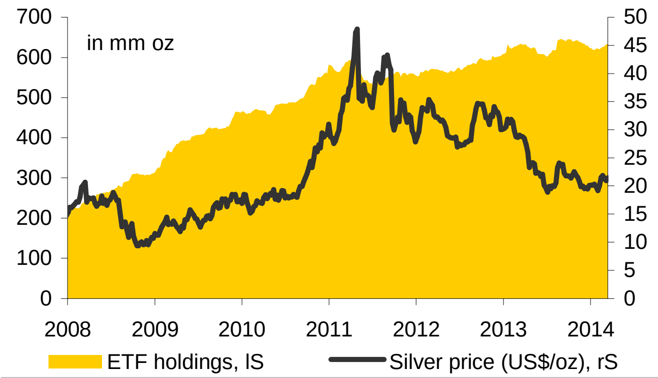

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 16: **Net long positions of money managers (Silver)**



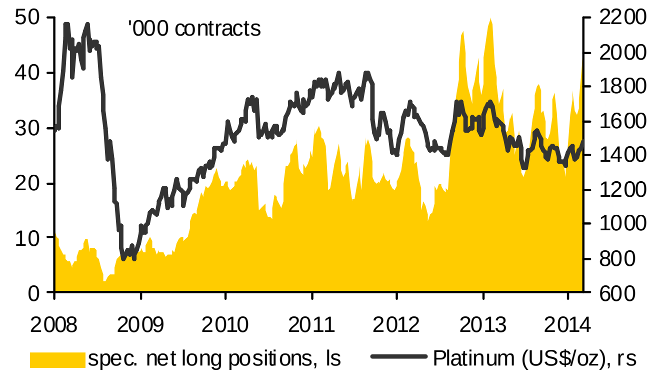

*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

CHART 17: **Silver: ETF holdings**



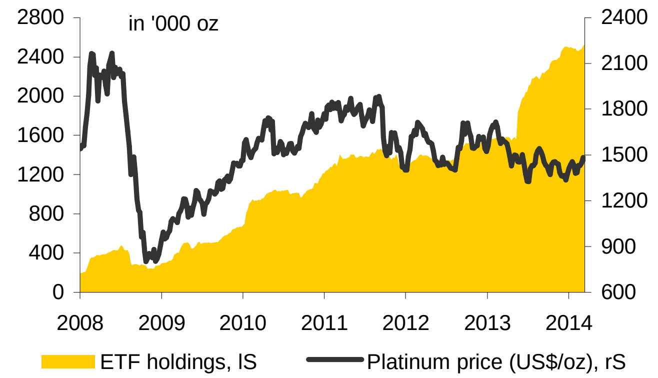

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 18: **Net long posit. of non-commercials (Platinum)**



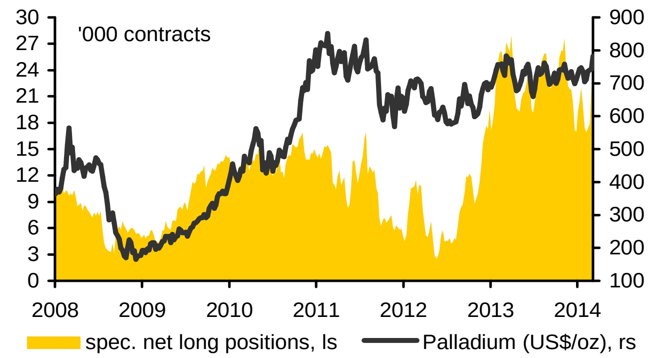

*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

CHART 19: **Platinum: ETF holdings**



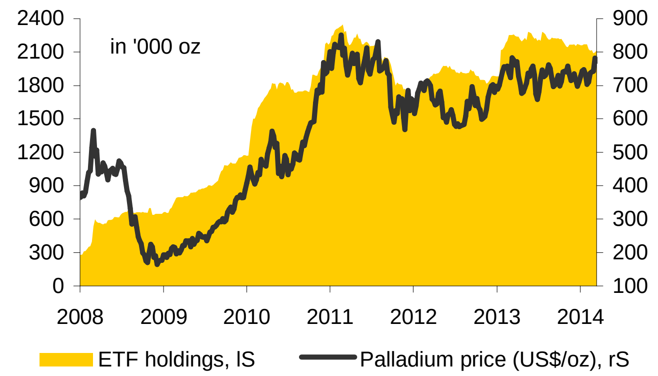

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 20: **Net long posit. of non-commercials (Palladium)**



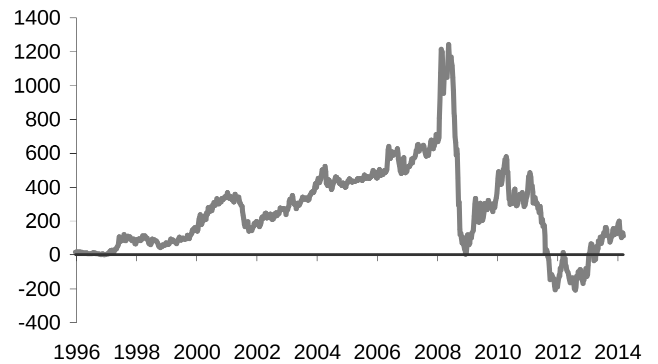

*Source: CFTC, Bloomberg, Commerzbank Corporates & Markets*

CHART 21: **Palladium: ETF holdings**



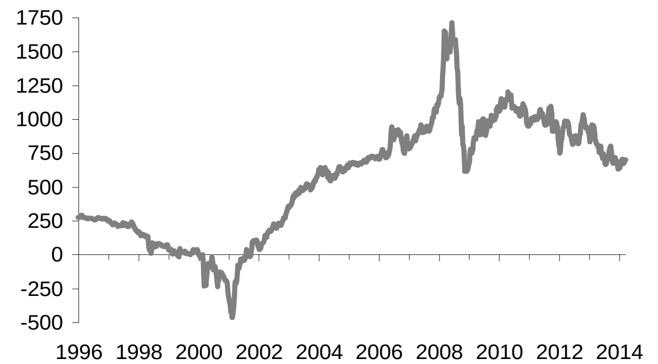

*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 22: **Price difference platinum vs gold (US$/oz)**




*Source: Bloomberg, Commerzbank Corporates & Markets*

CHART 23: **Price difference platinum vs palladium (US$/oz)**




*Source: Bloomberg, Commerzbank Corporates & Markets*

**Commerzbank Corporates & Markets**

| **Frankfurt** | **London** | **New York** | **Singapore Branch** | **Hong Kong Branch** |
|---|---|---|---|---|
| Commerzbank AG | Commerzbank AG<br>London Branch | Commerz Markets LLC | Commerzbank AG | Commerzbank AG |
| DLZ - Gebäude 2, Händlerhaus<br>Mainzer Landstraße 153<br>60327 Frankfurt | PO BOX 52715<br>30 Gresham Street<br>London, EC2P 2XY | 2 World Financial Center,<br>32nd floor<br>New York,<br>NY 10020-1050 | 71 Robinson Road, #12-01<br>Singapore 068895 | 29/F, Two IFC 8<br>Finance Street Central<br>Hong Kong |
| Tel: + 49 69 136 21200 | Tel: + 44 207 623 8000 | Tel: + 1 212 703 4000 | Tel: +65 631 10000 | Tel: +852 3988 0988 |