RBMC

THE BHAR REPORT

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The Week in the Markets

Week of 12 June 2020 – Number 22

Weekly price change	S&P 500	Shanghai	US 10-YR	DXY	$/CNY	WTI	Gold	LMEX	LME Cu	LME Al	LME Ni	LME Zn	LME Pb	LME Sn
Last	3,070	2,920	0.71%	96.6	7.07	$36.7	$1,732	2,607	$5,772	$1,602	$12,584	$2,007	$1,721	**$16,918**
Change w-o-w	**-2.0%**	**-0.4%**	**-0.15**	**-0.2**	**-0.3%**	**-4.2%**	**1.5%**	**2.8%**	**3.6%**	**2.0%**	**-0.9%**	**-1.3%**	**-0.2%**	**5.3%**

Macro Themes

As of 12 June, about 7.5mn **Covid-19** cases have been confirmed worldwide, and the death toll has surpassed 421k, according to Johns Hopkins University data. Increasingly its apparent that re-opening will be gradual with testing and contact tracing needed until a vaccine has been developed and it is too early to declare victory on the virus (see **Chart 1**). Sentiment has been bolstered by **Europe** increasing its monetary and fiscal stimulus efforts (see **Dashboard**). The **ECB** has agreed to a EUR600bn expansion of its bond-buying programme. This comes after the EU proposed to create a EUR750bn rescue fund to support countries hit hardest by Covid-19. The brighter mood was capped by last Friday's stunning gain of 2.5mn **US jobs** during May. Economists had expected a loss of 7.5mn.

At Wednesday's **FOMC** meeting Fed Chair Powell delivered a dovish message to financial markets as the US central bank predicts no rate increases until at least the end of 2022. Warning that the US faces a "long road" to recovery, he said the bank would keep interest rates near zero for the foreseeable future. In their first economic projections since December, Fed officials estimated that by 2022, the US would still be facing 5.5% unemployment, far higher than pre-Covid-19 levels, with core inflation at 1.7%, still below its target of 2%. Crucially, the forecasts showed that almost all top Fed officials expected to keep interest rates close to zero through to the end of 2022 - offering not the slightest hint of an early tightening. "This is going to take some time," Mr Powell said. In its statement, the Fed was committed to expanding its balance sheet (+$3tn since March) and would increase its holdings of US Treasuries and agency mortgage-backed securities (MBS) "at least at the current pace to sustain smooth market functioning". It announced plans to buy ~$80bn of Treasuries between June 12 and July 13 and $40bn of MBS, maintaining its roughly $120bn a month rate.

Rather than putting the brakes on Fed support because of an unhealthy spike in financial markets, Mr Powell suggested there was a greater likelihood the Fed would take further action to bolster the US economy if it falters more than expected, either because of a second wave of Covid-19 infections or an underwhelming next round of fiscal stimulus. Having previously ruled out **negative rates**, the Fed chairman said central bankers were discussing potential moves including "explicit" **forward guidance** on interest rates, which would tie any increases to particular macroeconomic milestones or dates, and a more structured **asset purchase** programme. Mr Powell said the usefulness of so-called **yield curve** control - targeting specific interest rates depending on the duration of debt - was still an "open question", indicating it was not the first option.

The **World Bank** and the **OECD** published their outlooks on the global economy, projecting a decline in global GDP this year of 5.2% and 6%, respectively, much worse than that projected by the **IMF** when they made their predictions in April. Globally, the IMF is preparing to revise down a forecast 3% decline for 2020 as more information comes in. Both the World Bank and the OECD give two scenarios: a baseline forecast, and a downside forecast (double-hit scenario). Under the baseline forecast - which assumes that the pandemic recedes sufficiently to allow the lifting of domestic mitigation measures by mid-year in advanced economies and a bit later in emerging market and developing economies, that adverse global spillovers ease during the second half of the year, and that dislocations in financial markets are not long-lasting - global growth is forecast to rebound to 4.2% (World Bank)/5.2% (OECD) in 2021 (see **Chart 2**).

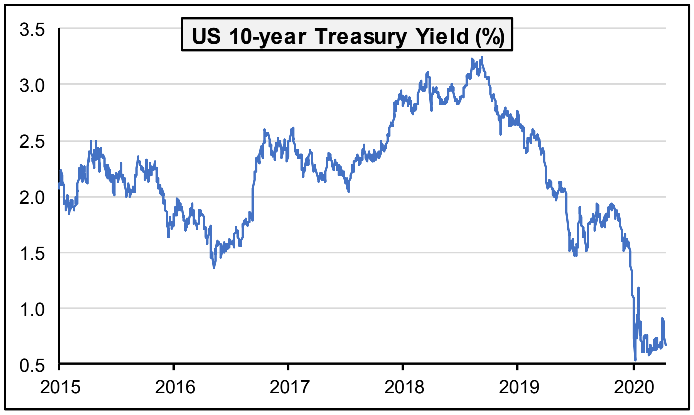
Precious Metals

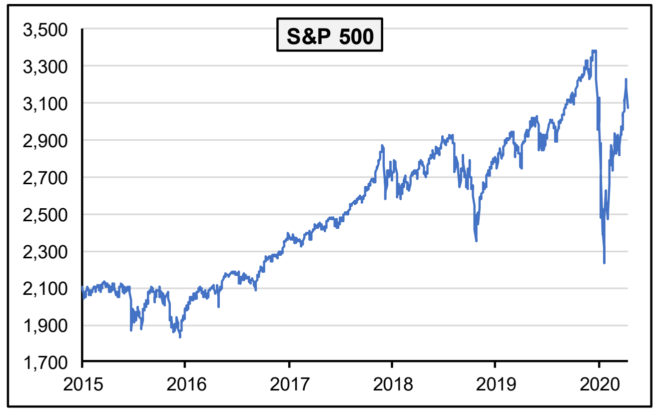
Gold rallied strongly after the Fed noted that low interest rates were here to stay and that asset purchases would continue at the present pace or more, while rates will remain near zero through 2022. There is still significant uncertainty about how the economic recovery will play out and any disappointments could support the gold price. **Silver** prices rallied even stronger, as investors looked to the precious metal as a cheaper option to dearer gold. The rollout of a global 5G network was expected to boost electrical demand for silver this year, according to *Heraeus*. Silver stands to benefit from the growth of 5G infrastructure and devices owing to its use in electrical contacts, such as semiconductors and multilayer ceramic capacitors (MLCCs). Electrical and electronic (EE) applications are the largest end-use for silver, accounting for 24% of total physical demand (248.5moz in 2018). However, EE demand has fallen by 50.2moz (-17.5%) since its peak in 2011, and 5G was expected to partially offset this decline in 2020. The **PGM**s were mixed; platinum lost ground on a weekly basis while palladium was flat. De-dieselization has led to increased emissions in Europe, but policy-makers are pushing EVs to meet CO_2 targets leading to a loss of ~450koz of **platinum** demand over the last three years, almost a third of the market's size. Vehicle sales in China are estimated to have risen by a further 11.7% in May, according to provisional data from the *China Association of Automobile Manufacturers*, with sales rising to 2.14mn units. This marks the second consecutive month of sales growth after 21 months of decline. China is the single largest autocatalyst market for **palladium**, accounting for around 21% of demand last year (~2.3moz).

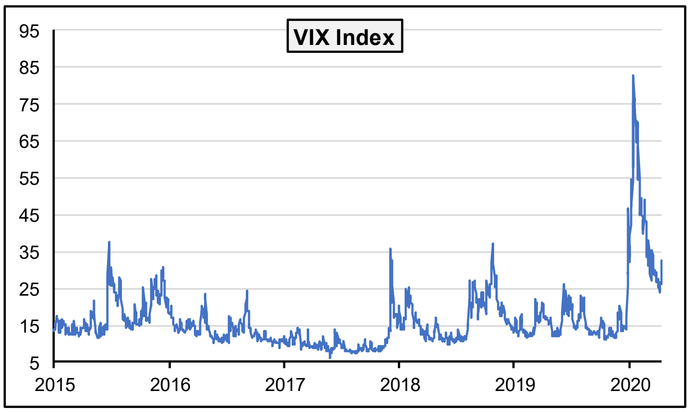
Base Metals

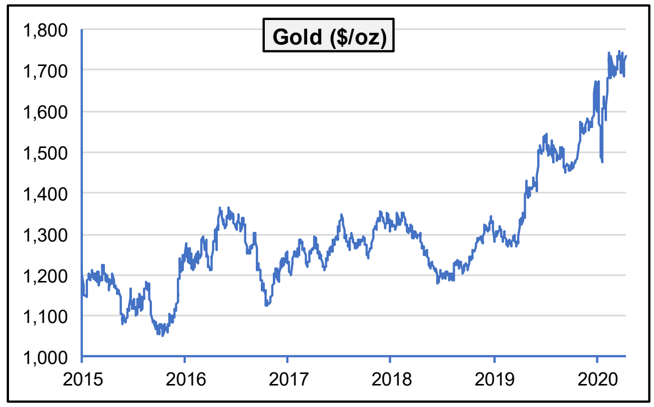
The **base complex** continued to go from strength to strength buoyed by expectations that demand in China will continue to recover. Markets were buoyed by a shoring up of stimulus packages (**China's NPC** and **Europe's Next Generation EU** initiative) and hopes that the relaxing of lockdowns would jump-start stalled economies. A pick-up in Chinese copper demand is reflected in higher physical premia (see **Chart 3**). Loose credit conditions will sustain the **wall of money** that currently drives the apparent divergence between asset prices and the state of the broader economy. We would not be surprised to see copper prices testing $6,000/t but a sustained break above this level would not be fundamentally justified, in our view. A substantial global market surplus this year is expected amid a deep economic recession. We would expect the price to gravitate back towards industry marginal costs in the low $5,000s. **Trafigura,** the world's biggest **copper** trader, believes demand will come back even stronger, driven by China and stimulus measures around the world. Global **aluminium** inventories are expected to surge by 5Mt by the end of the year to 16Mt, much of it in hidden warehouses (non-LME). LME aluminium inventories hit a three-year high of 1.54Mt and have surged by 52% over the past three months. Contango (cash-and-carry) trades are likely to be back in vogue as financial players absorb excess metal and profit from the forward curve. As **Chart 4** shows the return on a 1-year aluminium financing deal yields around 4%. Banks and other financiers (traders/merchants, hedge funds and investors) are able to borrow cheaply, negotiate low rent deals and store metal off-exchange. The forward curve remains in contango reflecting the accumulation of metal and weak prices at the front end of the curve. *Rusal* was seeing strong interest from traders seeking to exploit financing deals. Charts with moving averages are shown on **The Backpage**.

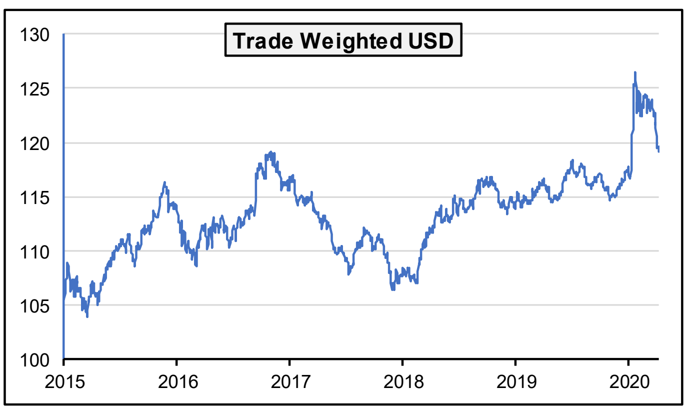
Dashboard – What You Need to Know

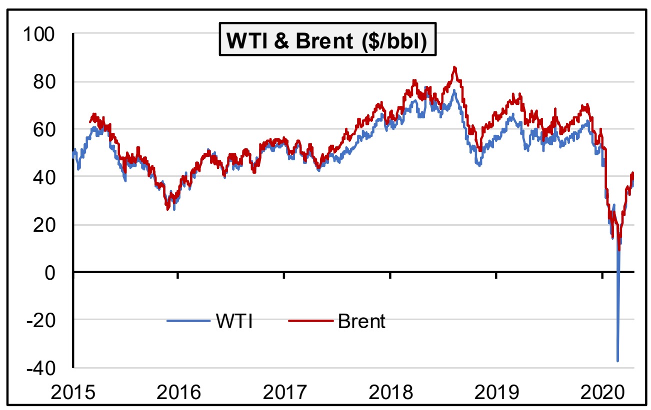


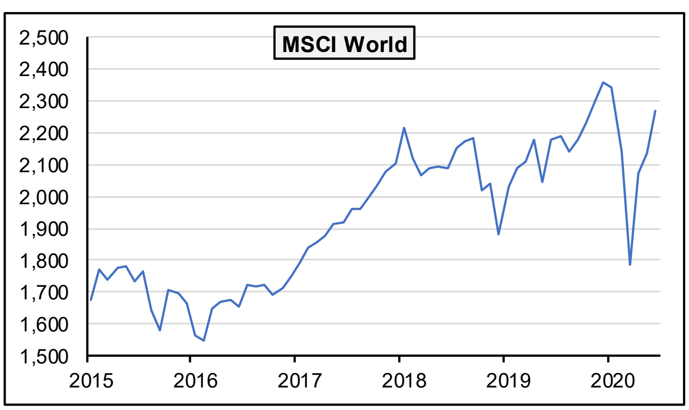


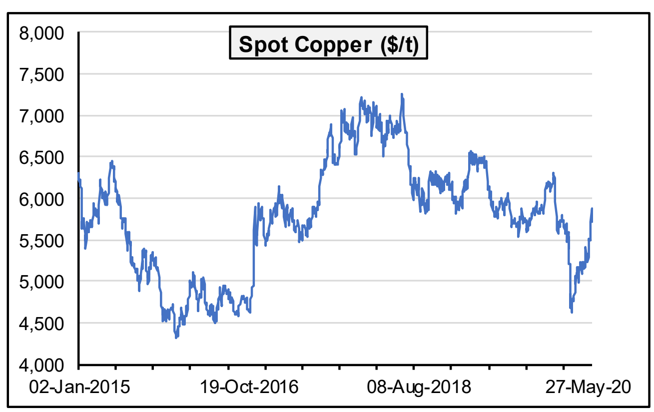












Source: Federal Reserve Bank of St. Louis, Trading Economics

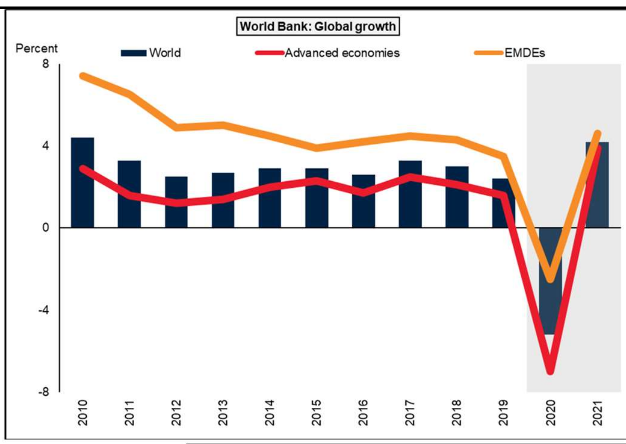
Charts of the Week

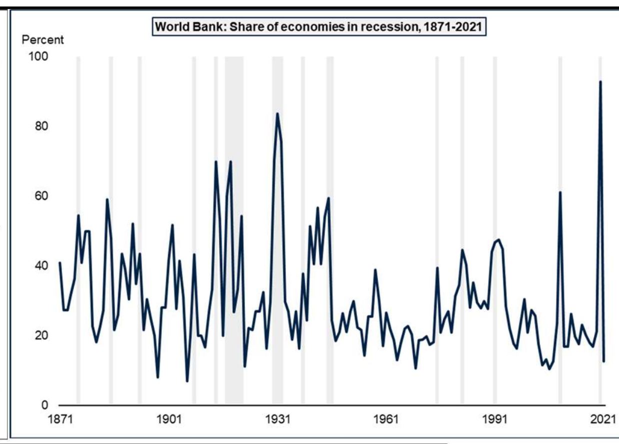
Chart 1. Too early to declare victory on the virus

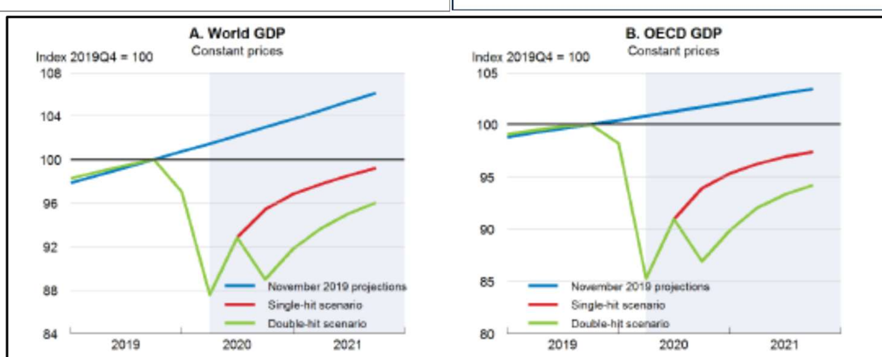
Factors needed for quick and robust recovery	Recent news	Looking ahead
Infection contained (travel restrictions can be eased)	Governments broadening reopening Mixed bag of results – Germany/ Italy/ Spain (good) vs Portugal/ Sweden/ ME (signs of second wave)	Vigilance to second wave risks, particularly in the US
Policy response - Fiscal stimulus of sufficient size and nature - Central bank backstop - Absence of 'nationalism' and political scapegoating	ECB expanded PEPP (QE) by EUR600bn	EU Recovery Fund Fed dovish, BoE next week Brexit US and China tensions/ US political risk
Economic resilience - proof of 'suspended animation'	Strong US employment report	Extension to US unemployment benefits? UK furlough cont.? 2nd quarter earnings season round the corner

Source: J.P. Morgan Asset Management

Chart 2. World Bank and OECD Economic Outlooks







Note: November 2019 projections are from the November 2019 OECD Economic Outlook.
Source: OECD Economic Outlook 107 database; and OECD Economic Outlook 106 database.

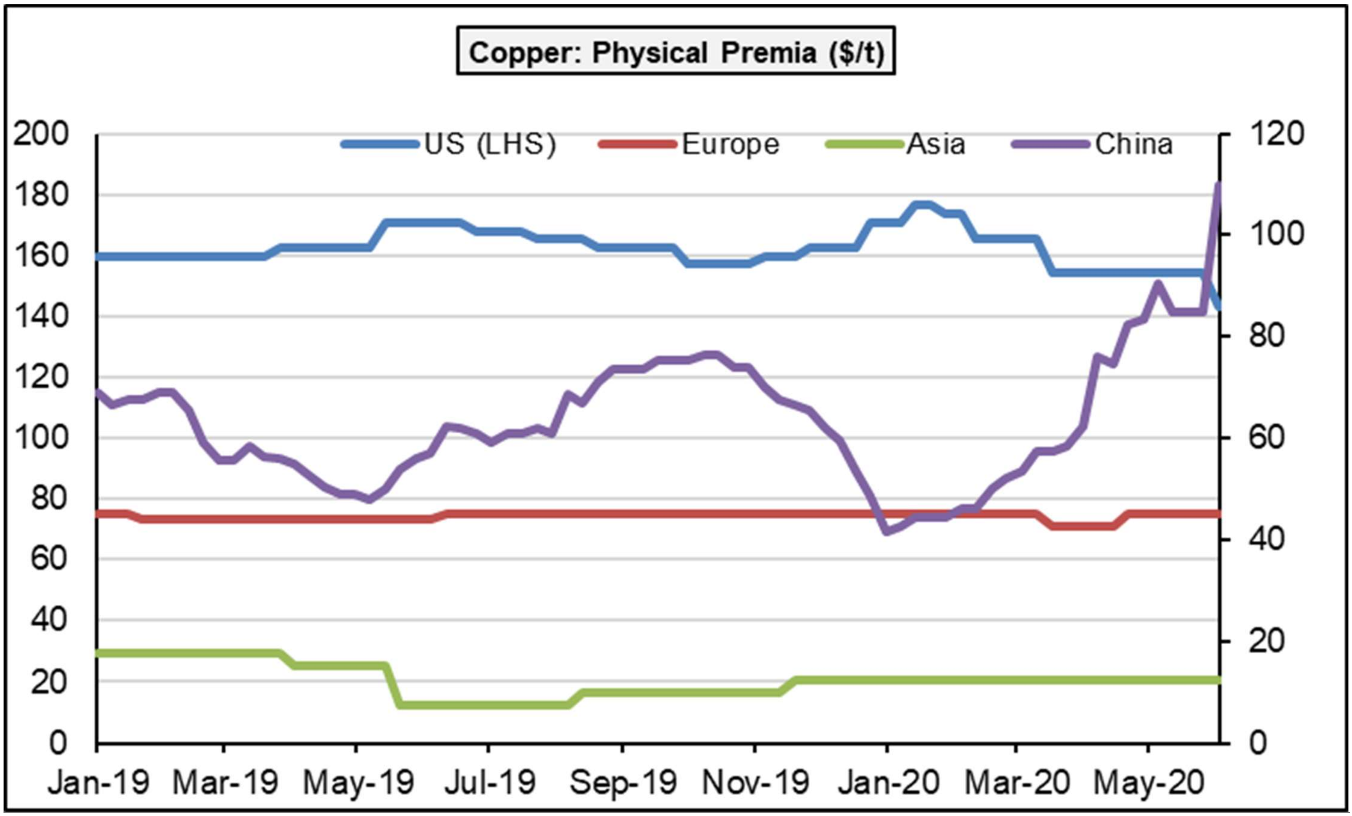
Global Economic Growth Forecasts

	Date of forecast	Global GDP (%) 2020f	2021f
IMF	06-Apr-20	-3.0	5.8
World Bank	08-Jun-20	-5.2	4.2
OECD	10-Jun-20	-6.0	5.2

Source: World Bank, OECD, RBMC

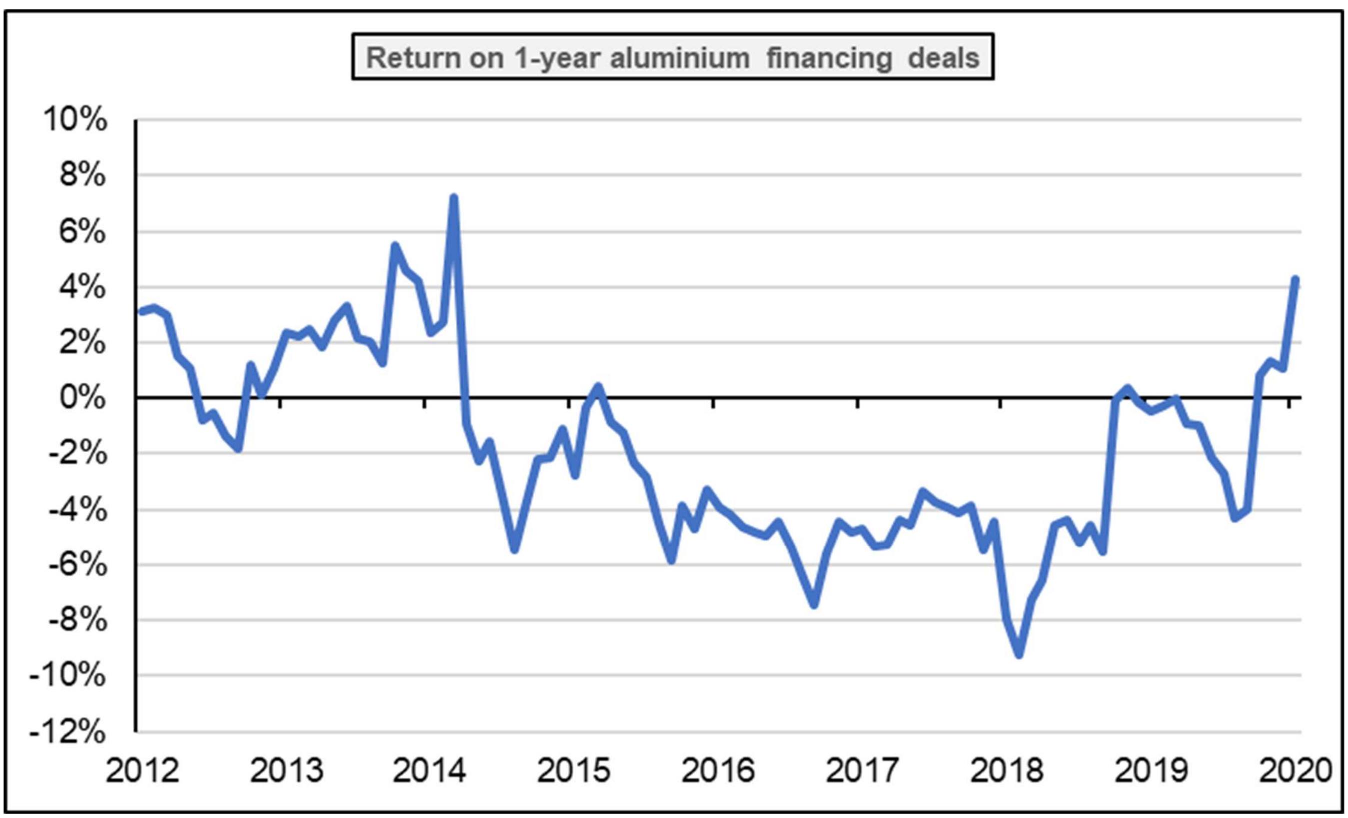
Charts of the Week

Chart 3. Copper: Physical premiums rising in China



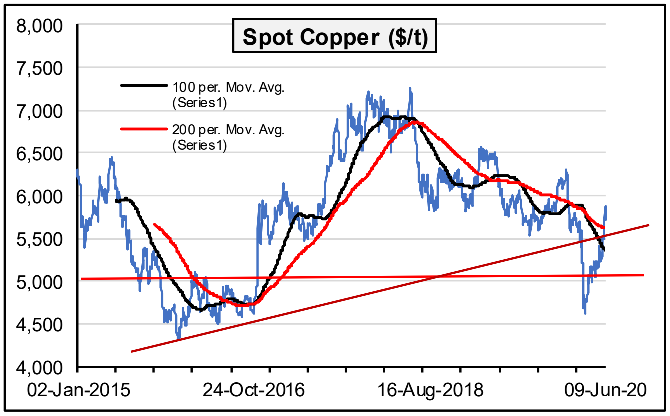
Source: Fastmarkets, industry reports, RBMC

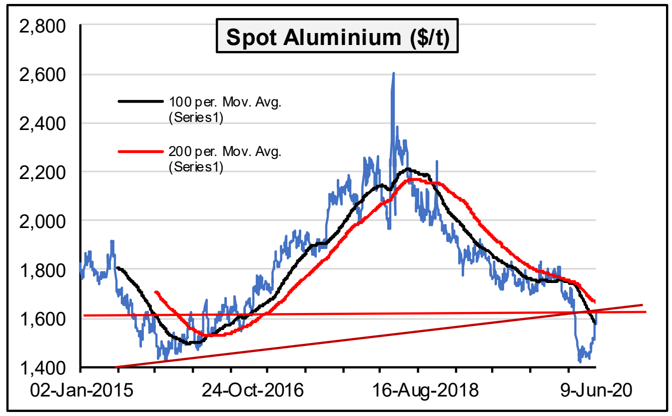
Chart 4. Financing aluminium is profitable at present, yielding 4%

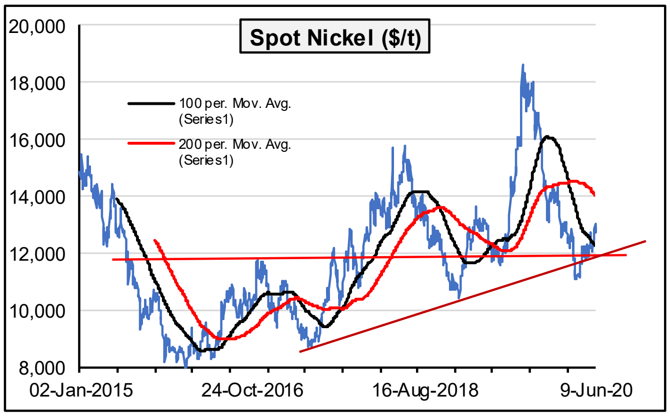


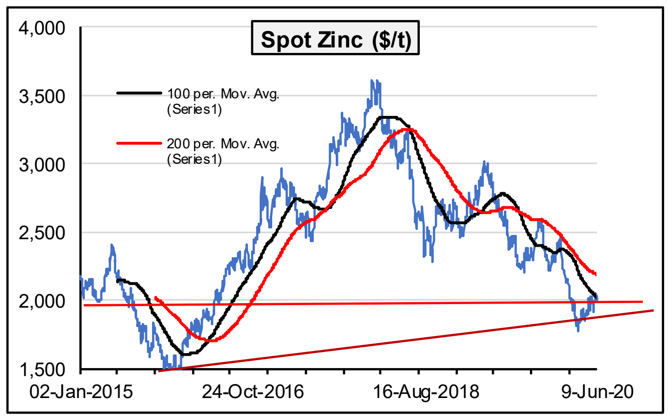
Source: Fastmarkets, Federal Reserve Bank of St. Louis, LME, RBMC

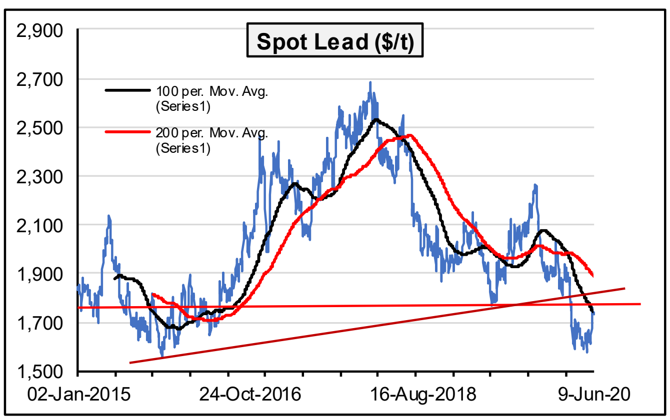
The Backpage – Industrial Metals

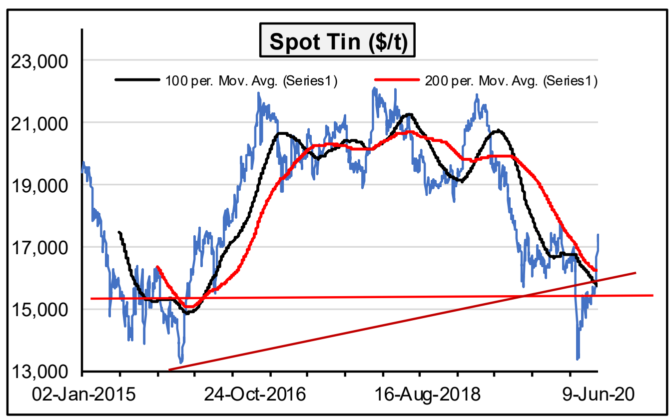


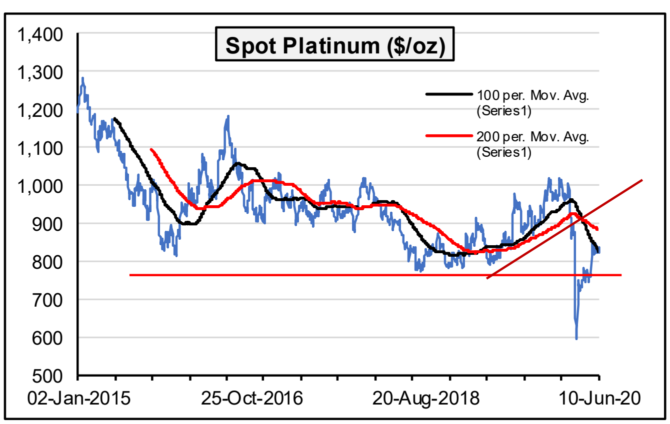


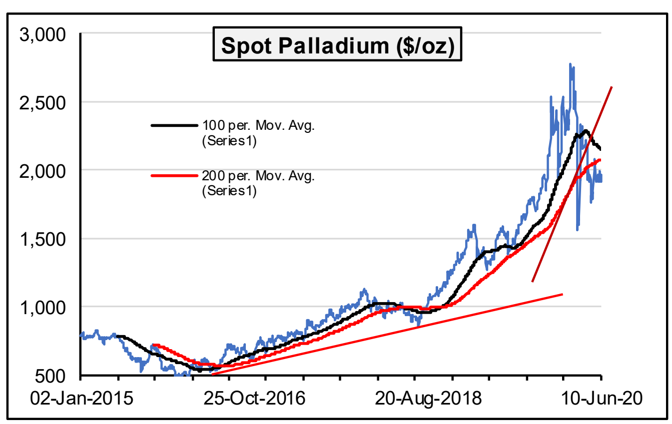












Source: LME, LBMA, LPPM, RBMC

For more commentary see my blog on www.rbmc.world
Comments, suggestions, and feedback is welcomed