RBMC

THE BHAR REPORT

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The Week in the Markets

Week of 22 May 2020 – Number 19

Weekly price change	S&P 500	Shanghai	US 10-YR	DXY	WTI	Gold	LMEX	LME Cu	LME Al	LME Ni	LME Zn	LME Pb	LME Sn
Last	2,933	2,814	0.64%	99.7	$31.9	$1,736	2,473	$5,261	$1,521	$12,712	$1,984	$1,641	$15,500
Change w-o-w	2.8%	-1.9%	0.02	-0.6	14%	0.2%	3.5%	1.3%	3.1%	5.9%	1.4%	2.6%	3.1%

Macro Themes

As of 22 May, about 5.1mn **Covid-19** cases have been confirmed worldwide, and the death toll has surpassed 303k, according to Johns Hopkins University data. Increasingly its apparent that reopening will be gradual with testing and contact tracing needed until a vaccine has been developed (see **Chart 1**). The Covid-19 pandemic led to a 3% drop in **global trade** values in Q120. The downturn is expected to accelerate in Q220, according to **UNCTAD** forecasts, which project a quarter-on-quarter decline of 27% (see **Chart 2**).

Debt is soaring and unorthodox **policy stimulus** from central banks is in over-drive due to Covid-19. The cost of such efforts is inevitable: **inflation** will come roaring back over the coming years. Or will it? A deep recession, even of a short and sharp variety, means that **deflationary** forces are strongest at the moment – underlined by the latest consumer price data from the US and China. And time is a slow healer of any pronounced **"output gap"** (*a measure of spare capacity that estimates the difference between the economy's current level of output and what it could produce without generating inflation*). Many economists do not expect that gap to close before 2021. The **IMF** forecasts a total loss of about $9tn in global output over the next couple of years.

This suggests that central banks will struggle to meet their **inflation target**, just as they struggled in the aftermath of the GFC. Indeed, expectations of inflation in the bond and derivatives markets for the next decade are still stuck at very low levels in both the US and Europe, with only a modest uptick from their recent lows. Some argue that pent-up consumer demand will drive prices higher during the recovery, while others say it will be caused by higher costs of production as companies start to unpick their global supply chains. Larry Summers, a former US Treasury Secretary, says that an outcome of **"secular stagnation"** has been very low inflation. Summers thinks this will persist, especially in the short-term while demand is so weak. However, he did admit that the "dispersion of possible outcomes" is now wider, suggesting some need to build defences against higher inflation in future.

For now, central bank purchases of bonds are designed to keep long-dated **yields** low (see **Dashboard**), and as a result, the stimulus provided by **QE** remains locked within the financial system. This has been the story for more than a decade of QE spurring inflation in the prices of financial assets rather than spilling out into the broader economy. Many note Japan's post-bubble experience, which suggests that a huge increase in the **monetary base** does not automatically lead to inflation. Others argue, that as global **demographics** deteriorate, so **disinflation** becomes politically attractive; old people prefer low prices to protect their savings. Also stemming an inflationary surge is the risk of exacerbating government **deficits**, which would cause an adverse reaction in bond markets. It might be too much to anticipate a **1970s-stlye** resurgence of price rises. But denying outright an eventual rise of inflation seems foolish.

Precious Metals

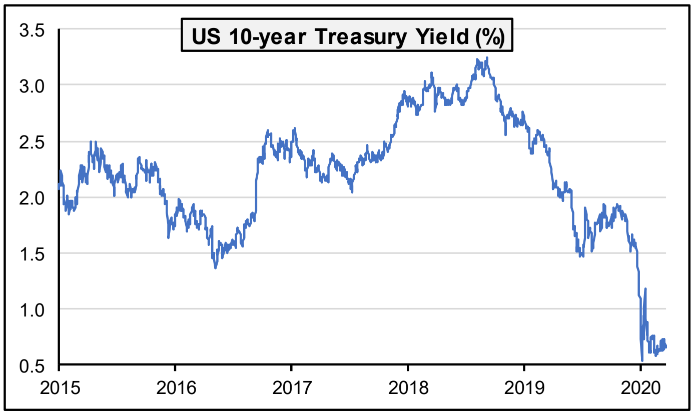
Precious metals saw safe-haven buying on rising trade tensions and as Fed chair Powell warned that the US economy may not "fully recover" until the end of 2021 and that long-term unemployment could damage the economy. As such, he reiterated his commitment to use a full range of tools to support the economy, including leaving interest rates near zero until the economy is back on track. The Fed Funds futures market continues to price in **negative** interest rates by early 2021. However, subzero rates do not guarantee an economic recovery and do not appeared to have helped the Japanese or European economies in any way. Holders of **gold** – a classic inflation hedge that has risen by about one-third over the past year – certainly sense their moment has come when they look at central banks upping their holdings of government and corporate bonds. With the Fed's balance sheet set to rise beyond $10tn this year, some argue this could become a permanent feature of monetary policy, tipping the financial system towards outright debt monetization.[1] Latest **CFTC COT** data showed current gold speculative net length is still only 45% of the largest net longs over the past three years, so net length is not yet at extreme levels and there is more firepower for gold if we continue to trend higher (see **Chart 3**). **Platinum** and **palladium** markets will be tight this year as the coronavirus pandemic hammers supply and demand, **Johnson Matthey** said. Production and their consumption by auto makers could fall by around one-fifth in 2020 but the course of the virus is too uncertain to give precise numbers, the company said in a report. The cold market balance, whatever it may be in the end, may not be the biggest determinant of price direction and volatility when you have large parts of the market offline and the potential mismatch between supply and demand coming back. Covid-19 will disrupt supply of platinum and rhodium more than palladium, Johnson Matthey said. **Heraeus** and **SFA Oxford** said they expected platinum prices around $680/oz in the next six months, with palladium around $1,675/oz and **rhodium** around $5,250/oz.

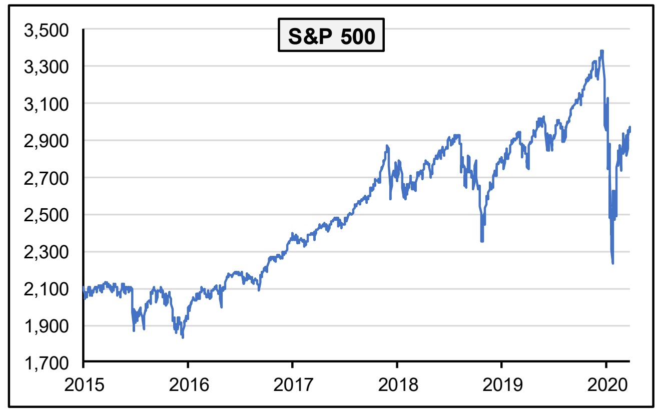
Base Metals

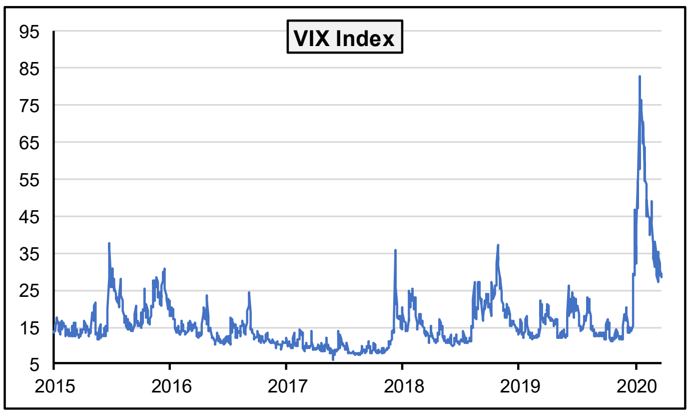
Sentiment continued to improve as the global economy re-opens and demand picks-up. Prices continued to be buoyed by the recovery in the housing sector in China and a softer **USD**. Growth in house prices accelerated in April, with new home prices in 70 major cities rising 0.42% YoY, up from 0.13% growth in March. China's **industrial production** rose by 3.9% YoY in April, reversing a 1.1% fall in May and out-performed expectations of a 1.5% gain. **Retail sales** decreased 7.5% YoY in April (expected -9.3%) a significant improvement over May (-15.8%). **Fixed-asset investment** dropped 10.3% YoY to CNY7.74tn in Jan-Apr 2020, compared to a 16.1% plunge in Q120. China will set out its major economic objectives and policy goals for 2020 at the **National People's Congress which started yesterday** - fiscal stimulus of 5-8% of GDP is likely to be announced, half the size of the stimulus that followed the GFC. The biggest beneficiary of this stimulus will be the **transport** and **infrastructure** sectors. Tightness in the **copper** market shows no sign of easing - China's **coppe**r treatment charges (that miners pay smelters) fell to $55/t, matching levels not seen since 2012. A **Reuters** poll of analysts show demand and supply for industrial metals are expected to drop this year as Covid-19 and lockdowns to contain its spread disrupt manufacturing and mining activity. Demand losses caused by the Covid-19 pandemic will outweigh the impact of supply disruptions for metals such as **aluminium** and **zinc**, leaving these markets with huge surpluses and high stocks. Fundamentals for **copper** and **nickel** are expected to be relatively strong as lockdowns in producer countries limits supply and helps to offset the drop in demand (see **Chart 4**). The huge uncertainty was reflected in the wide range of forecasts of global market balances for each metal. For example, in the case of copper the maximum global surplus for 2020 was anticipated at 574kt and the minimum global surplus was only 20kt. The **World Bureau of Metals Statistics** (**WBMS**) published data for Q120 on demand, supply, stocks, and market balances which appears to confirm this trend. Only **lead** and **tin** were in deficit (see **Chart 4**). Charts with moving averages are shown on **The Backpage**.

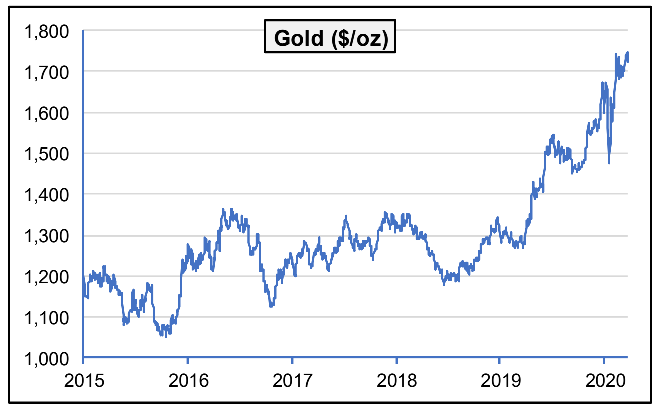
[1] Central banks engaging in "monetary financing" a permanent expansion of their balance sheets as they buy government debt with the aim of funding the government.

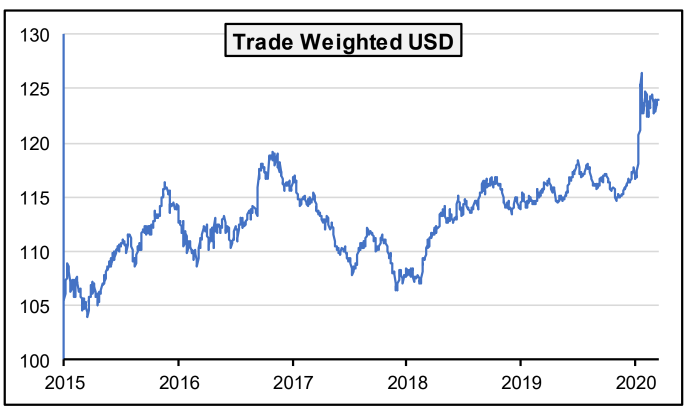
Dashboard – What You Need to Know

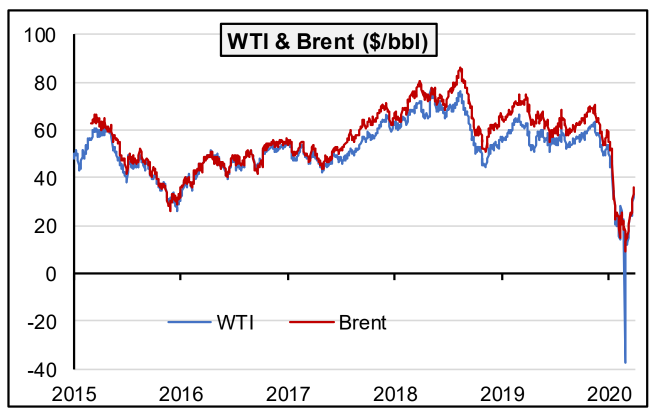


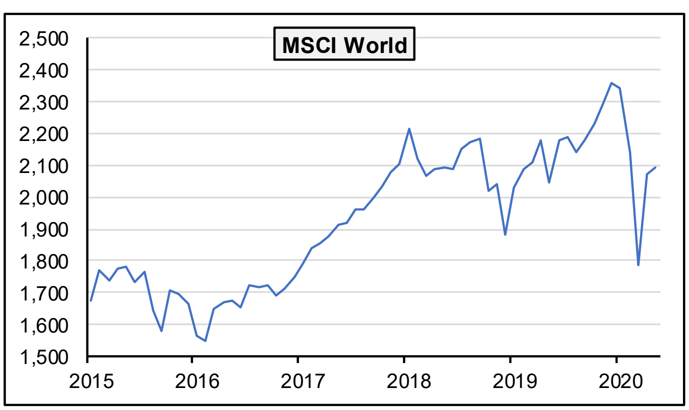


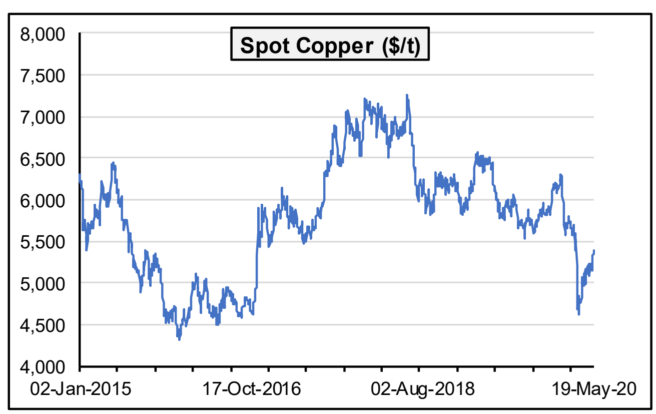












Source: Federal Reserve Bank of St. Louis, Trading Economics

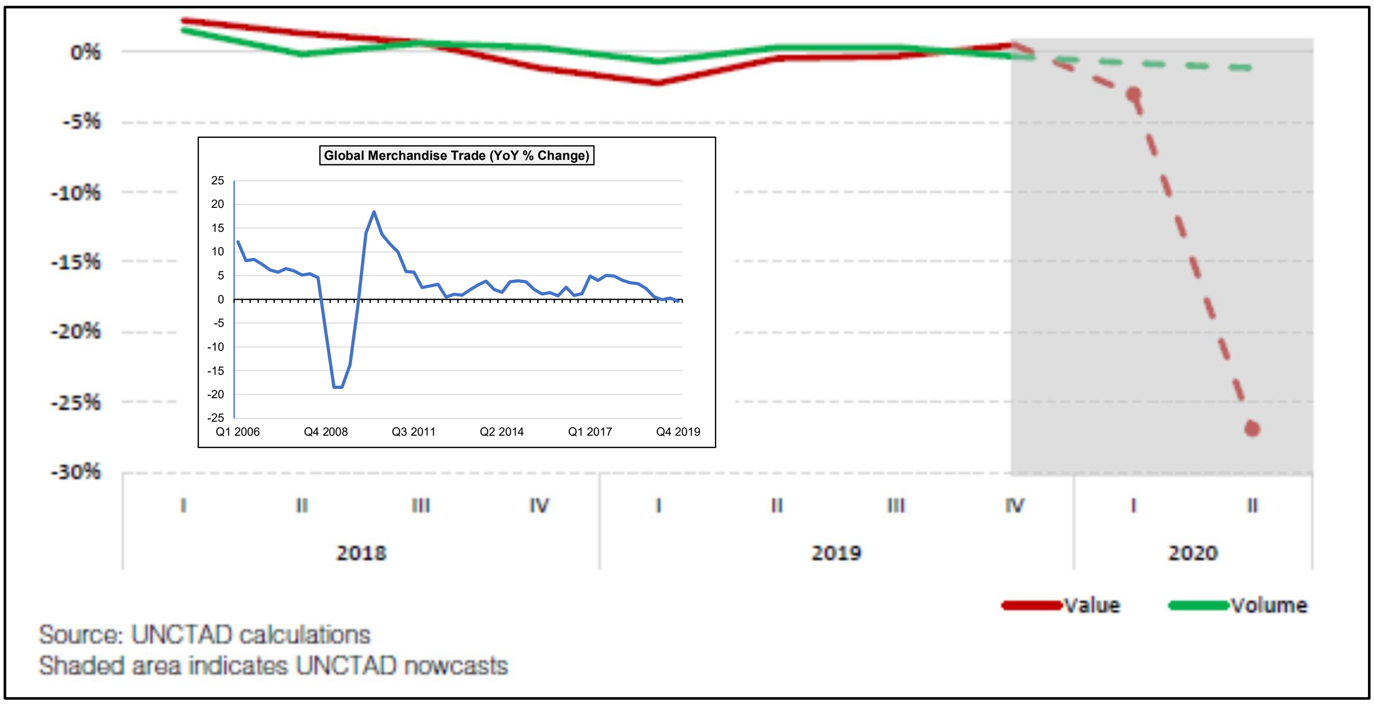
Charts of the Week

Chart 1. So far so good, but early days on reopening

Factors needed for quick and robust recovery	Progress	Further progress needed
Infection contained (travel restrictions can be eased)	Phase I of Moderna vaccine Infections slowing in Continental Europe Infections plateauing in the US, UK	Vaccine proceeds to Phase II Re-opening does not lead to resurgence of infections Stabilisation in infection rates in EM
Policy response - Fiscal stimulus of sufficient size and nature - Central bank backstop - Absence of 'nationalism' and political scapegoating	Franco-German proposal for EUR 500bn recovery fund dispersed in grants Fed's Powell "not out of ammunition by a long shot" BoE discussing negative rates	ECB backstop unaffected by German Court ruling Brexit negotiation extension US and China tensions given Biden and Trump comments
Economic resilience - proof of 'suspended animation'	Supply cuts/ demand move stabilised oil prices	Increased discussion of conditional loan forgiveness Monitoring unemployment

Source: J.P. Morgan Asset Management

Chart 2. Global Merchandise Trade (Growth rate over previous quarter, seasonally adjusted series)



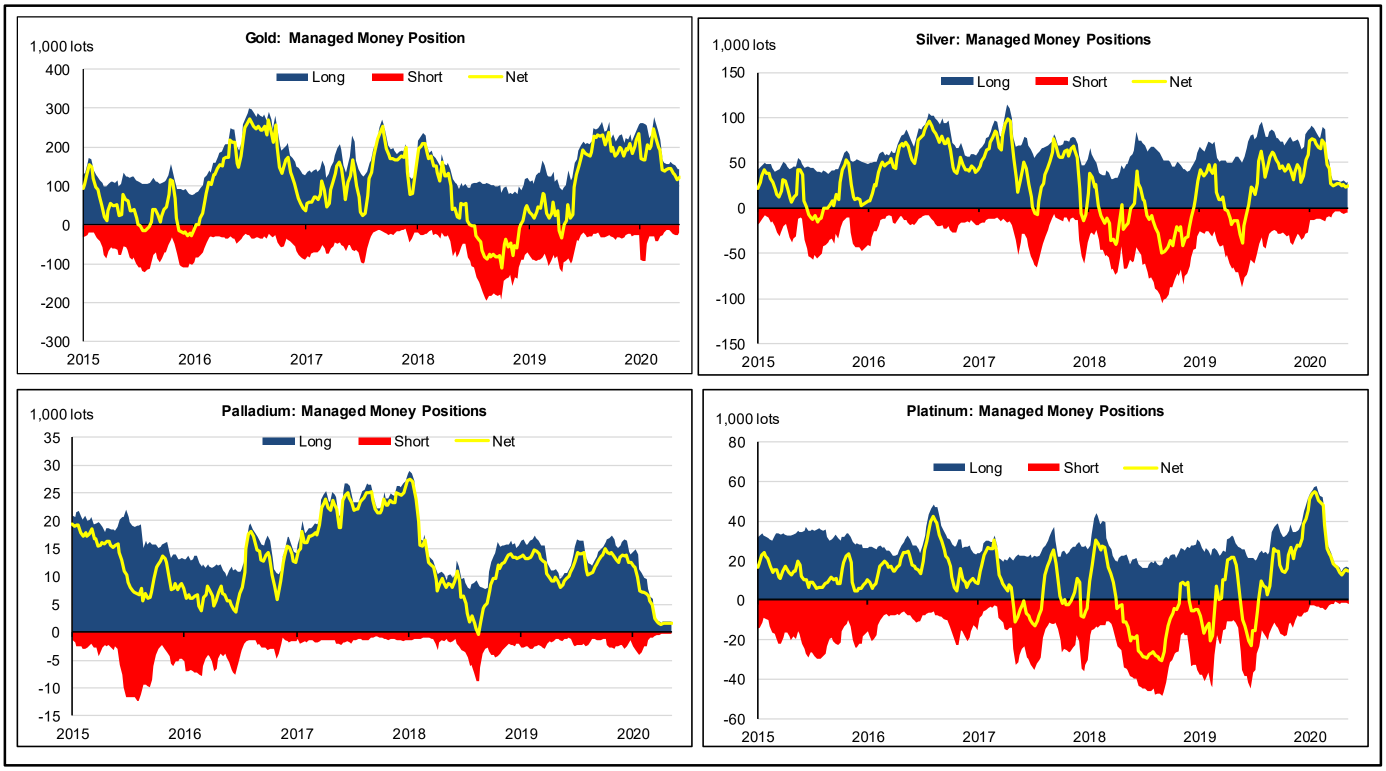
Source: UNCTAD

Charts of the Week

Chart 3. CFTC Futures Net Spec Positioning

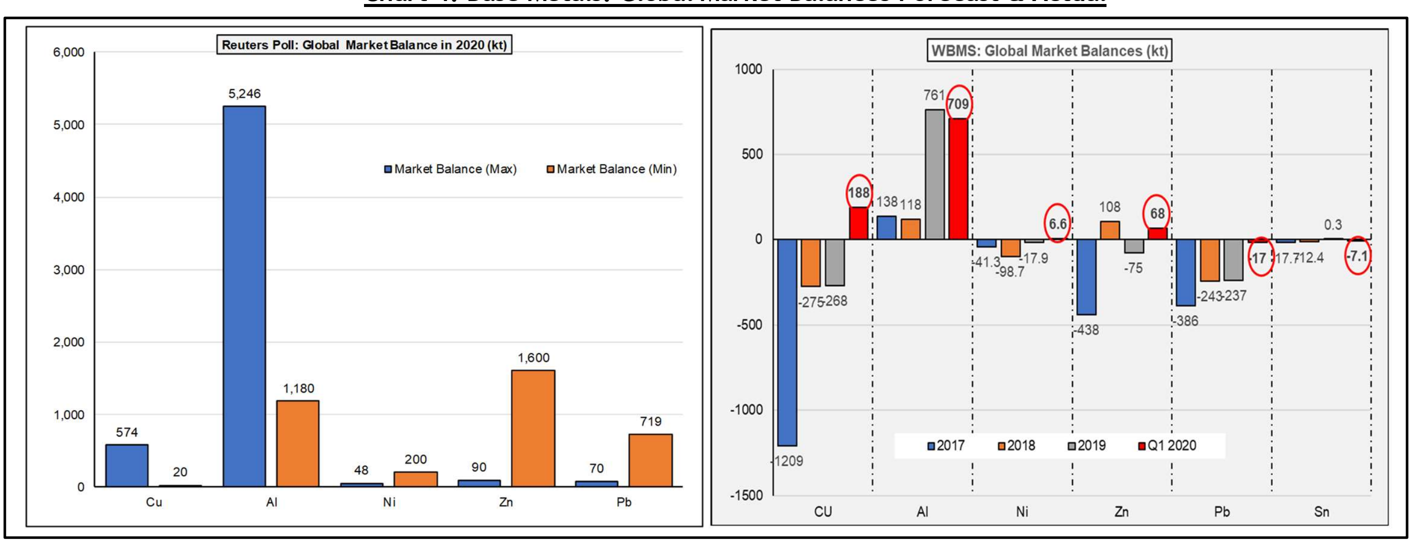
CFTC Futures Net Spec (1,000 lots)

	Gold	Silver	Platinum	Palladium
Last	123.9	24.4	14.5	1.6
WoW Change	7.9	0.7	-0.6	-0.1
MoM Change	-22.5	-2.2	0.1	0.1
YoY Change	71.3	38.6	1.5	-6.5
Max 3Y	273.1	98.6	54.8	27.5
Min 3Y	-109.5	-48.9	-30.4	-0.5
Last / Max 3Y	**45%**	**25%**	**26%**	**6%**



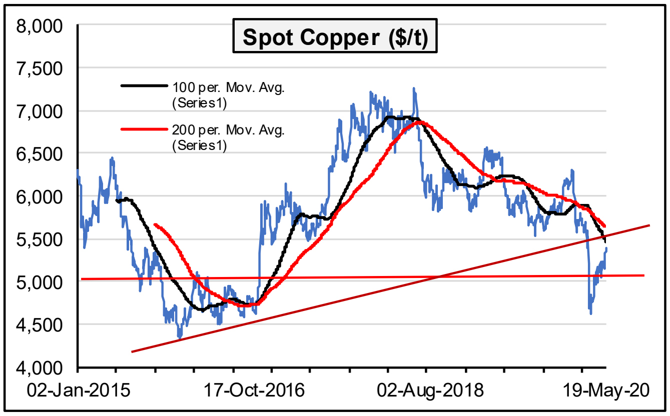
Source: CFTC COT

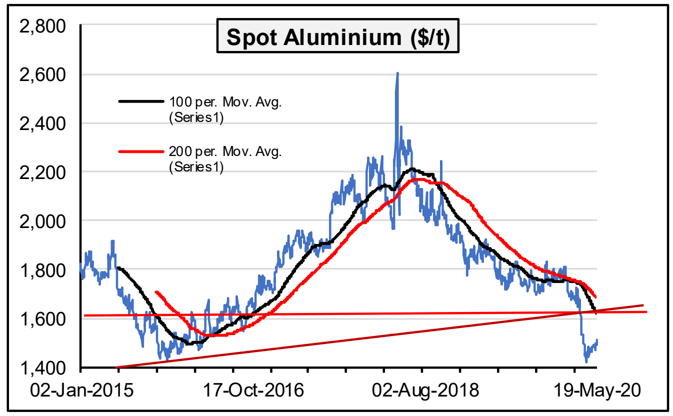
Chart 4. Base Metals: Global Market Balances Forecast & Actual

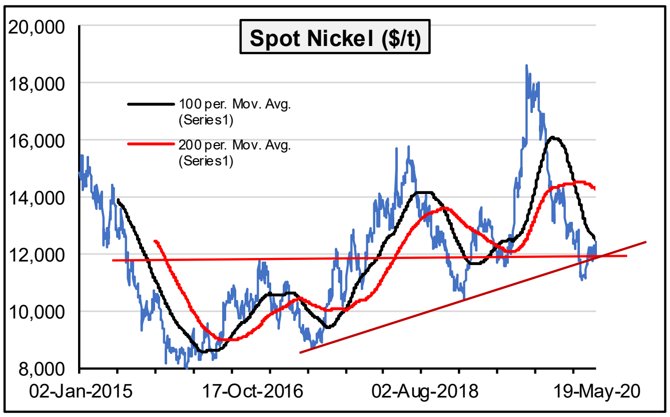


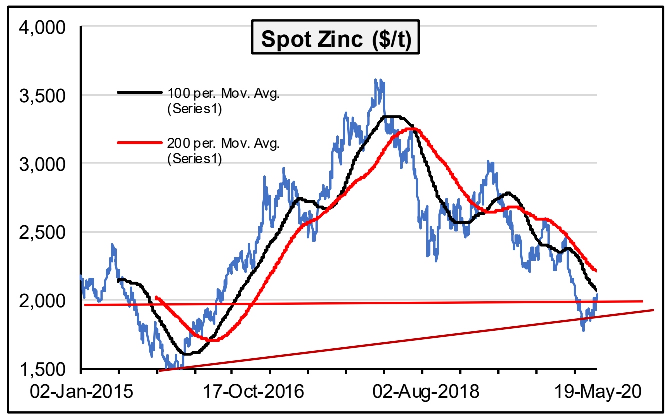
Source: Reuters Polls, WBMS

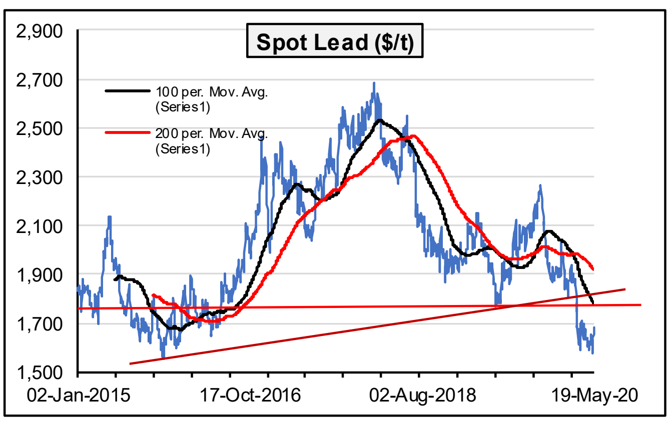
The Backpage - Industrial Metals

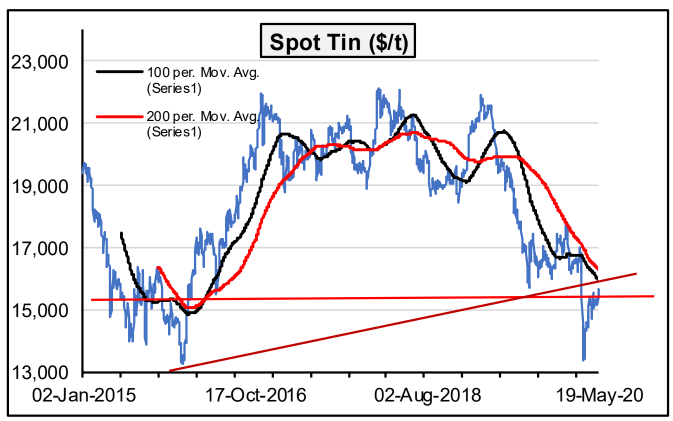


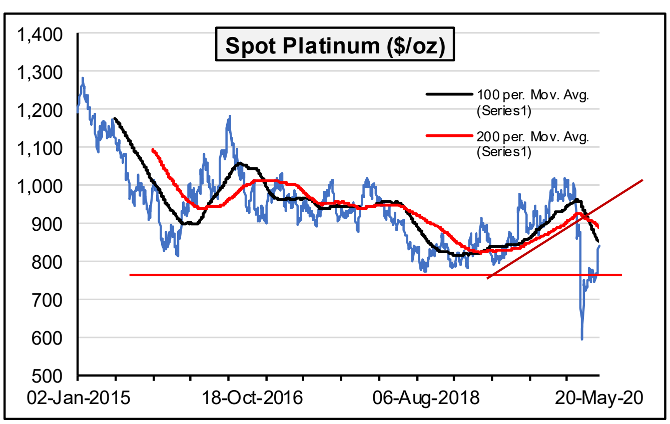


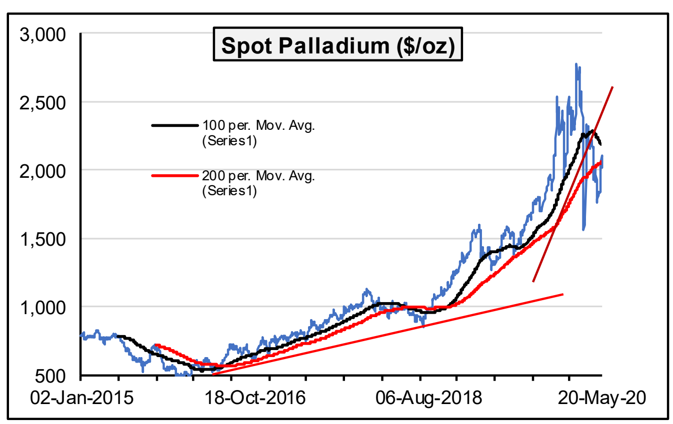












Source: LME, LBMA, LPPM

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