Precious Metals Outlook

Group Economics
Macro & Financial Markets Research

24 November 2016

Gold hit by Trump reflation

Georgette Boele
Co-ordinator FX & Precious Metals Strategy
Tel: +31 20 629 7789
georgette.boele@nl.abnamro.com

- **Gold prices have dropped below USD 1,200 on the Trump reflation trade…**
- **…and silver and platinum prices weakened even more**
- **Palladium is the star performer because of the cyclical implications**
- **We expect gold prices to weaken to USD 1,100 in 2017…**
- **… though they should recover in 2018**
- **Silver and platinum will likely follow gold prices…**
- **…while palladium prices will remain resilient**

Trump leaves its mark on precious metal prices

Gold prices rallied temporarily on Donald Trump's election victory. However, investor sentiment made a dramatic U-turn. The sharp rise in US Treasury yields and the rally in US equity markets in an environment of positive investor sentiment triggered a substantial rally in the US dollar and caused a crash in gold prices. The price behaviour signals that every rally in gold prices is used as an opportunity by investors to unwind existing long gold positions. This is a negative sign for the gold price outlook. This week gold prices cleared the psychological level of USD 1,200 per ounce as the rally in US Treasury yields and the US dollar continued on better than expected US economic data releases. Since the US presidential elections gold prices have dropped 7%, platinum by 8% and silver by 11%. Meanwhile, palladium prices rose in tandem with industrial metal prices driven by expectations of higher demand and positive investor sentiment.

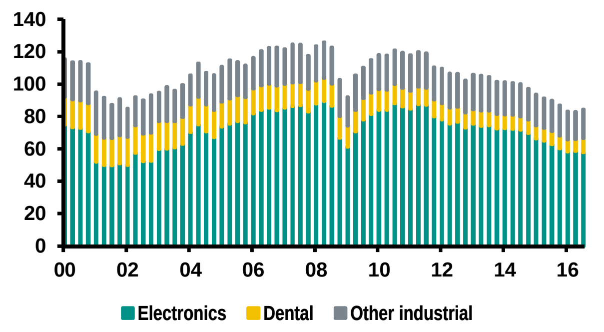
We remain negative on gold for 2017

We expect the current negative environment to remain in place for gold prices in 2017. Investor demand remains the most crucial driver pushing gold prices lower. From an investor point of view there is little reason to hold gold as an investment. For a start, rising inflation expectations are more than countered by the rise in US Treasury yields and expectations about upcoming rate hikes by the Fed. As a result, US real yields are rising which is a major negative for gold prices. Moreover, higher inflation expectations have not triggered major inflation fear (yet). As long as real yields rise and there are no major inflation fears, gold prices will go lower and not higher. What is more, the last leg of a powerful rally in the US dollar is in full swing. This is a powerful cyclical rally where higher US equities, expectations of more Fed rate hikes and expectations of a strong uplift in the US economy drive the US dollar. This is being reflected in the portfolio inflows into US equities and cyclical bonds. Investors will find zero-income paying asset gold and other precious metals unattractive because of higher income in equities and bonds, with the exception of palladium, which has a strong cyclical exposure.

The net long positions in the futures market and in ETFs have been reduced but overall positions are still large. In the current environment we expect investor position liquidation to continue leading to a cutback in net-positions in the futures market to an average level of 100,000 contracts and also a considerable cutback in total ETF positions. Therefore, we expect that gold prices will drop towards USD 1,100 (above the low set in 2015). Lower gold prices will likely stimulate jewellery demand and industrial demand. We expect jewellery demand and industrial demand to rise at a modest pace. This will not compensate for lower investor demand but merely dampen the size of the move down.

Some bottoming out in industrial demand…

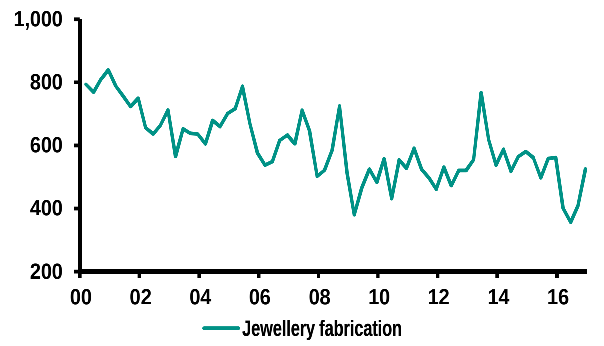
In metric tons



Source: GFMS Thomson Reuters Datastream

…and also in jewellery demand

In metric tons



Source: GFMS Thomson Reuters Datastream

Gold price driver net negative in 2017 but supportive in 2018

	Our base case 2017	Result for Gold	Our base case 2018	Result for Gold
Fed	+75bp vs +50bp market expectations	Negative	+50bp vs +40bp market expectations	Neutral
ECB	No tapering, forward guidance to Sep 17	Positive	Expectations of tapering	Negative
BoJ	More easing In line with market	Neutral	Expectations of tapering	Negative
PBoC	One rate cut	Neutral	No easing	Neutral
CB Brazil	Limited easing	Neutral	Limited easing	Neutral
Other CBs	Unlikely to ease further	Negative	Unlikely to ease further	Negative
US real yields (10y)	To rise modestly	Negative	To decline modestly	Positive
Government bond yields	To rise modestly	Negative	To decline modestly	Positive
Inflation expectations	To rise modestly	Positive	To stabilise	Neutral
US growth	Strong upward momentum	Negative	To roll-over	Positive
Global growth	Modest upward momentum	Negative	Modest upward momentum	Negative
US dollar	Dollar rally to continue	Negative	Trunaround and weakening dollar	Positive
Investor sentiment	To be constructive	Negative	Neutral	Neutral
Eurozone political risk	Uncertainty but no escalation	Neutral to positive	Uncertainty but no escalation	Neutral to positive
Brexit	Risk of Hard Brexit	Positive	Risk of Hard Brexit	Positive
Technical outlook	This years uptrend is over	Negative	If 2015 low holds recovery is possible	
Jewellery demand	To improve	Positive	To improve	Positive
Industrial demand	To improve	Positive	To improve	Positive

Source: ABN AMRO Group Economics

…but a recovery in gold prices in 2018

If gold prices are able to bottom out above the 2015 low (USD 1,046 per ounce), investors will likely be more willing to buy gold as the price is more attractive. In 2018, we expect the US growth/inflation mix to deteriorate meaning that US growth will slow down while inflation remains relatively high. Therefore, the Fed will continue to hike interest rates in 2015. This should be negative for gold prices but by that time, our scenario for Fed rate hikes will likely be fully anticipated. We expect the US dollar to peak in 2017 and to weaken considerably in 2018. This is good news for gold prices as well as 10y US real rates will likely also peak and move lower. All together this should give an incentive for investors to position in gold again. This together with higher jewellery demand from China should support a price recovery back to USD 1,300 per ounce.

Silver also weaker in 2017

Since the US Presidential elections silver prices have underperformed the other precious metals. Once again silver proves to be gold's volatile brother. Silver price drivers are similar to gold price drivers. For example, despite having a considerable amount of industrial demand, investor related activity is the dominant and most fluid source of demand. This is reflected in the strong negative relationship with the US dollar and US Treasury yields. As both have risen silver prices have tumbled. For 2017 this does not bode well for silver. We expect a higher US dollar and higher US yields. Therefore, we expect silver prices to weaken to US 15 per ounce and then to bottom out. As is the case for gold, we expect a recovery in silver prices in 2018 as the drivers become net-positive, especially investor related demand.

2017 to be a weak year for silver but an improvement in 2018

	Our base case 2017	Result for Silver	Our base case 2018	Result for Silver
Gold	Lower gold prices	Negative	Gold price recovery	Positive
US dollar	Dollar rally to continue	Negative	Turnaround and weakening dollar	Positive
Fed	+75bp vs +50bp market expectations	Negative	+50bp vs +40bp market expectations	Neutral
US real yields	To rise modestly	Negative	To decline modestly	Positive
Government bond yields	To rise modestly	Negative	To decline modestly	Positive
Chinese growth	To slow down at modest pace	Neutral to negative	To slow down at modest pace	Neutral to negative
US growth	Strong upward momentum	Positive	To roll-over	Negative
Japanese growth	To weaken	Negative	To weaken	Negative
Indian growth	Flat growth	Neutral	Flat growth	Neutral
Investor sentiment	To be constructive	Negative	To be constructive	Negative
Brexit	Risk of Hard Brexit	Positive	Risk of Hard Brexit	Positive
Technical outlook	This years uptrend is over	Negative	If 2015 low holds recovery is possible	

Source: ABN AMRO Group Economics

Divergence between platinum and palladium

One of the most remarkable developments has been the strong outperformance of palladium prices since the US Presidential elections compared to the other precious metal prices. Whereas gold, silver and platinum have dropped by 7-11%, palladium prices have rallied by 11%. Once again palladium proves to be a completely different animal than the other precious metals. Palladium prices are mainly driven by the industrial demand and car sales demand outlook and supply expectations. Meaning it is the precious metal which is the least investor driven and the most fundamentally driven. As financial markets went on a reflation trade following the substantial upward adjustment in expectations about the

US economy, palladium prices surged in line with the strong rise in other industrial metal prices such as copper and iron ore prices. What is more, the US and emerging markets such as China are the most important markets for palladium demand. The outlook for the US has been sharply revised upwards and the outlook for China has become less negative. Both are very positive for the palladium price outlook. We expect the divergence between palladium and the other precious metals to persist in 2017. However, as prices have already jumped substantially, we expect the upward momentum to fade slightly. This is because a higher US dollar and lower gold silver and platinum prices will cap the upside in palladium prices.

For platinum investor behaviour dominates…

	Our base case 2017	Result for platinum	Our base case 2018	Result for platinum
Gold	Lower gold prices	Negative	Recovery in gold prices	Positive
US dollar	Dollar rally to continue	Negative	Turnaround and weakening dollar	Positive
Car sales EU	To slow down	Negative	To slow down	Negative
Car sales China	Strong growth to cool somewhat	Neutral to negative	Strong growth to cool somewhat	Neutral to negative
Car sales US	To continue to rise	Positive	To slow down	Negative
Car sales Japan	To slow down	Negative	To slow down	Negative
Jewellery demand China	Modest rise	Positive	Modest rise	Positive
Electronics world	Modest rise	Neutral to posítve	Modest rise	Neutral to posítve
Mine production	To decline	Positive	To decline	Positive
Investor sentiment	To be constructive	Neutral to positive	To be constructive	Neutral to positive
Brexit	Risk of Hard Brexit	Negative	Risk of Hard Brexit	Negative
Technical outlook	Negative	Negative	If 2015 low holds recovery is possible	

Source: ABN AMRO Group Economics

The sharp drop in the platinum/palladium cross could result in some substitution between palladium and platinum. The cross is at levels not seen since 2003 and we think that at some point in 2017 the ratio will become too stretched. Why has platinum not profited from the reflation trade? First, for platinum car sales demand from the eurozone is more crucial. Second, platinum is much more sensitive to developments in the gold price. This is because of the substantial amount of jewellery demand. Palladium is barely dependent on jewellery demand. Third, palladium has a deep supply deficit. Last but not least, net speculative positions in palladium are low while in platinum there is still room for position liquidation. In short, lower gold prices will also drag down platinum prices because investor position liquidation. For 2018 we are also more optimistic on platinum prices and we expect platinum then to catch-up with palladium as well.

…while for palladium it is mainly the outlook on the US and China

	Our base case 2017	Result for palladium	Our base case 2018	Result for palladium
Gold	Lower gold prices	Negative	Recovery in gold prices	Positive
US dollar	Dollar rally to continue	Negative	Turnaround and weakening dollar	Positive
Car sales EU	To slow down	Negative	To slow down	Negative
Car sales China	Strong growth to cool somewhat	Neutral to negative	Strong growth to cool somewhat	Neutral to negative
Car sales US	To continue to rise	Positive	To slow down	Negative
Car sales Japan	To slow down	Negative	To slow down	Negative
Jewellery demand China	Modest rise	Positive	Modest rise	Positive
Electronics world	Modest rise	Neutral to posítve	Modest rise	Neutral to posítve
Mine production	To decline	Positive	To decline	Positive
Investor sentiment	To be constructive	Positive	To be constructive	Positive
Brexit	Risk of Hard Brexit	Negative	Risk of Hard Brexit	Negative
Technical outlook	Neutral	Neutral	Neutral	Neutral

Source: ABN AMRO Group Economics

ABN AMRO precious metals forecasts

Changes and new forecasts in red/bold

End period	24-Nov	Dec-15	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Gold	1,186	*1,061*	*1,316*	1,200	1,150	1,100	**1,100**	**1,100**	**1,150**	**1,200**	**1,250**	**1,300**
Silver	16.3	*13.9*	*19.17*	16.50	16.00	**15.00**	**15.00**	**15.00**	**16.00**	**17.00**	**18.00**	**19.00**
Platinum	919	*894*	*1,027*	900	875	850	**850**	**850**	**900**	**950**	**975**	**1,000**
Palladium	734	*562*	*721*	**700**	**725**	**725**	**725**	**725**	**750**	**750**	**750**	**750**

Average	Q4 16	2016	Q1 17	Q2 17	Q3 17	Q4 17	2017	Q1 18	Q2 18	Q3 18	Q4 18	2018
Gold	1,258	1,258	1,175	1,125	**1,100**	**1,100**	**1,125**	**1,125**	**1,175**	**1,225**	**1,275**	**1,200**
Silver	17.0	17.1	16.3	**15.5**	**15.0**	**15.0**	**15.4**	**15.5**	**16.5**	**17.5**	**18.5**	**17.0**
Platinum	925	998	888	863	**850**	**850**	**863**	**875**	**925**	**963**	**988**	**938**
Palladium	**665**	599	**713**	**725**	**725**	**725**	**722**	**738**	**750**	**750**	**750**	**747**

Source: ABN AMRO Group Economics

Find out more about Group Economics at: **https://insights.abnamro.nl/en/**

ABN·AMRO