

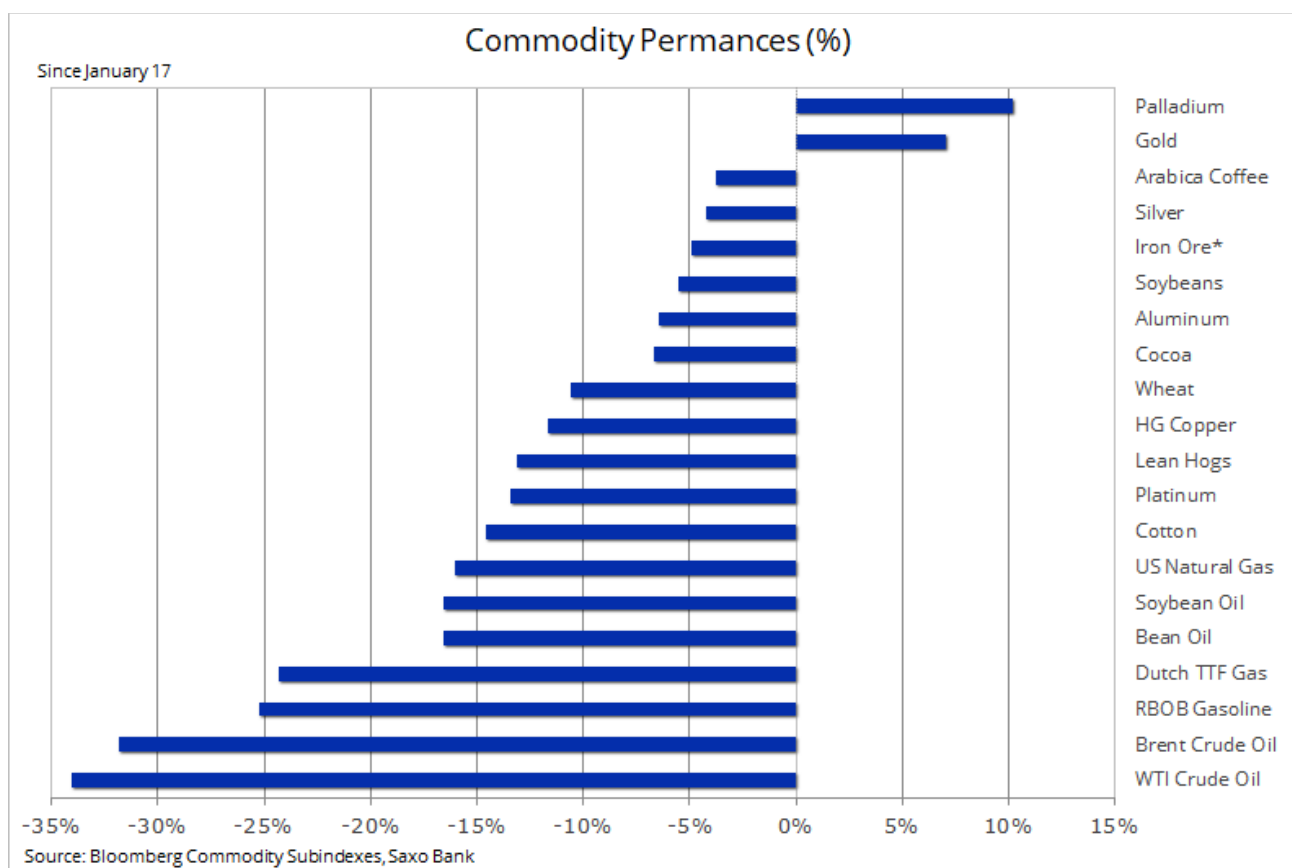
Commodity weekly: Gold shines as the clouds darken

By Ole S. Hansen | March 6, 2020

The negative economic impact of the coronavirus that for weeks has been signaled through weakness in pro-cyclical commodities finally spread like a wildfire to the rest of the market. The week kicked off with an emergency 50bp rate cut by the U.S. Federal Reserve, a move that only strengthened the sense of panic in the market. Within a few days, global sovereign bond yields had collapsed to a record low, gold and stock market volatility spiked while the dollar came under some significant selling pressure as longs were exited.

Disrupted global supply lines and an abrupt change in global consumer habits helped send global airlines, restaurants, leisure and hotel stocks sharply lower. The crude oil market experienced its own crisis with OPEC and Russia struggling to find common ground in order to mitigate the biggest downshift in global demand since the global financial crisis. While China is showing signs of slowly recovering, the focus turned to the U.S., the world's biggest economy.

A broken healthcare system and an unhealthy working culture has raised concerns that the nation could be on the cusp of a major outbreak.



Onto these wild market swings and uncertainty gold once again provided a safe haven against emerging turmoil. The biggest weekly gain since 2009 took it to levels not seen for seven years, leaving both silver and platinum trailing in the process. The gold-silver ratio hit a 40-year high at 96 while platinum's discount to gold reached a record \$820/oz. before announced production cut backs from Anglo American's platinum unit helped support a comeback.

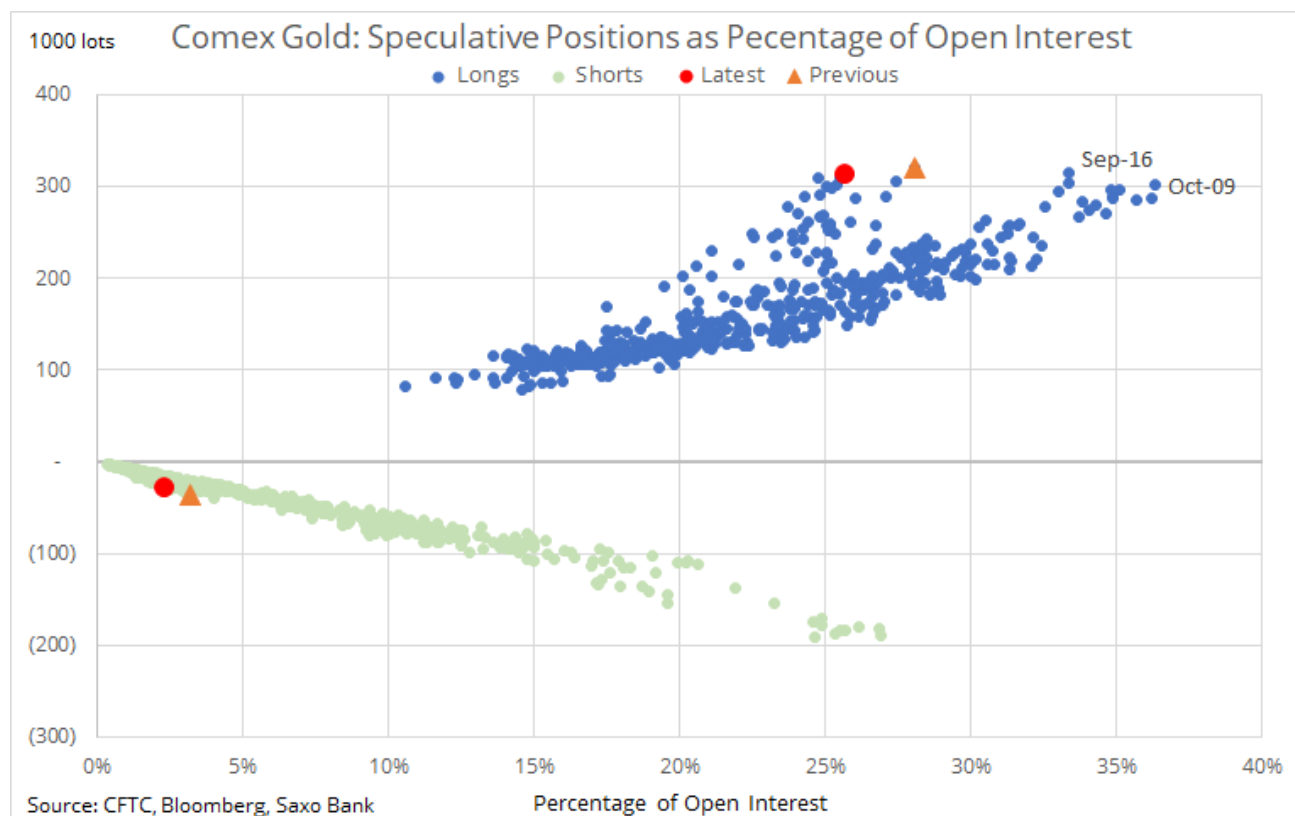
A perfect storm of supporting factors drove gold's rally and outperformance. Safe haven demand aside, it was the collapse in U.S. 10-year real yields to -0.60%, a seven-year low, sudden dollar weakness - as yield spreads to other currencies collapsed - and continued stock market weakness that helped propel gold higher towards \$1700/oz.

The emergency rate cut from the U.S. Federal Reserve on Monday to 1.25% is, according to market expectations, likely to be followed by another 50 bp cut at the regular FOMC meeting on March 18. So far, the low point stands at 0.20% which could be reached before the November U.S. elections.



The elevated speculative position held by funds has raised some concerns about a sharp correction should volatility spike again like it did last week. When volatility spikes, funds targeting a certain level of volatility in their portfolio are forced to reduce exposure across the board. This development hit gold last week when the Cboe VIX jumped to 40% (currently 37%).

Spiking volatility aside, some concerns have also been raised about the sustainability of a near-record long. It reached 285,000 lots in the week to February 25 before the mentioned VIX spike undoubtedly took some length out of the market. However, looking at the length relative to the size of the cake, i.e. the open interest, we find the position has not yet elevated when compared with levels reached during the past 12 years.



Spot gold was heading for its highest daily close in seven years close to \$1700/oz. With another 50bp rate cut already priced in, the prospect for additional gains depend on continued safe haven demand. With this in mind, the U.S. stock market, the dollar and bond market performances hold the key to further gains.



Source: Saxo Bank

Crude oil's week-long collapse continued with Brent crude oil falling to a 32-month low below \$50/b. While copper, which has now settled into a range, derives half of its demand from China, the energy sector reflects

development across the global economy. The spreading of the coronavirus from China is posing an increased threat to global growth and fuel demand has taken a hit as companies ban travel and supply chains are disrupted.

Faced with the biggest demand shock since the global financial crisis, the OPEC+ group of producers met in Vienna to hammer out a response to the current collapse in demand. Talks about a 1.5 million barrel/day cut ran into problems with Russia balking at the decision, instead saying they would rather wait until June in order to gauge the impact. Not only on demand but also the potential for a slowdown among other producers, not least from U.S. shale oil plays.

Forty or sixty dollar Brent crude oil is a question that the OPEC+ group of producers hold the key to. The answer to that question was given after finishing writing this update.



Source: Saxo Bank

Before the virus became known outside China in mid-January, OPEC, the U.S. Energy Administration and the International Energy Agency expected global demand growth in 2020 would rise by an average 1.2 million barrels/day. With this forecast in mind, together with the prospect of non-OPEC production rising by 2.3 million barrels/day growth, the OPEC+ group of producers made the early December decision to cut production to balance the market.

With demand growth now being revised lower to flat and by some to negative, the gap between supply and demand has now potentially risen by more than a million barrels/day. Hence the urgent need for OPEC+ to make another deep cut, with failure to do so carrying the risk of seeing oil plummet towards the low 40's.

Non-OPEC production, especially from U.S. shale oil, is likely to suffer a slowdown as well due to lower prices and tighter credit conditions. It may, however, still take months before the impact is being felt and time is really not what OPEC has given the ongoing and potentially worsening demand shock.



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