Global Precious Metals Comment
2019 Precious Metals Outlook: Fundamentals matter

FX

Global

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Gold tends to set the tone across precious metals…

We expect a broadly rangebound gold market in 2019, with some upside bias. We reiterate our outlook and price forecasts introduced in November, expecting an average of $1,300 next year, followed by modest annual gains throughout the remainder of our forecast period to 2023. This has implications on the rest of the precious metals complex, particularly on silver and platinum which have strong positive correlations to gold.

… but idiosyncratic fundamental factors also matter

For silver, any downside risks to growth are likely to act as a drag, given that over half of demand is attributable to industrial applications. But the price implications likely come through more via the impact on investor interest. We think it would take a strong rally in gold for silver to shake off this drag and for investors to have enough conviction to express the upside through silver. We lower our forecasts for silver to $15.8 for 2019 from $17.0 previously, and set our 3-month target at $15.3, implying some improvement in the gold:silver ratio. Despite a potential boost from gold, platinum is likely to drag its feet on any move higher, given poor supply and demand fundamentals – we continue to forecast surpluses in the years ahead. Investor sentiment remains weak. We lower our 2019 platinum forecast to $910 from $945, and make similar adjustments further out. Near-term, we set a slightly lower target of $875. Palladium, on the other hand, is likely to continue having moments of defiance against gravity, moving ahead of its peers and reacting to internal fundamental drivers. We expect volatility to continue, and for palladium to not be immune to interim corrections, especially during bouts of risk-off and/or soft patches in auto sales in the two key gasoline markets, US and China. But at the same time, a tightening market suggests that palladium will ultimately be resilient and market participants will take advantage of price fluctuations to build positions at better levels. We raise our 2019 palladium forecast to $1,130 from $1,040, and also lift our forecasts further out. We set a three-month target of $1,250, exercising caution in chasing the market higher, especially given weakness in equities and China car sales in recent months. Signs of extreme stress in the palladium market at the moment keep us on the sidelines for now. (See UBS Global I/O: Miners' Price Review – 2019 Outlook: Overweight into the New Year)

Figure 1: UBS precious metals forecasts and upside/downside scenarios

		Old base case	New base case	New vs Old % chg	Upside	Downside
Gold	2018E	1270	1270	0%	1280	1265
	2019E	1300	1300	0%	1400	1200
	2020E	1325	1325	0%	1455	1100
	2021E	1350	1350	0%	1480	1100
	2022E	1375	1375	0%	1510	1125
	2023E	1400	1400	0%	1535	1150
	LT (real)	1300	1300	0%		
Silver	2018E	15.9	15.7	-1%	15.8	15.6
	2019E	17.0	15.8	-7%	17.5	13.3
	2020E	17.5	17.3	-1%	20.5	11.5
	2021E	17.9	17.9	0%	21.3	11.3
	2022E	18.3	18.3	0%	22.3	12.1
	2023E	19.2	19.0	-1%	23.0	12.7
	LT (real)	17.0	17.0	0%		
Platinum	2018E	890	885	-1%	910	850
	2019E	945	910	-4%	1010	665
	2020E	1015	1000	-1%	1100	685
	2021E	1070	1030	-4%	1130	680
	2022E	1130	1130	0%	1230	750
	2023E	1196	1190	-1%	1290	810
	LT (real)	1060	1060	0%		
Palladium	2018E	1000	1025	3%	1050	990
	2019E	1040	1130	9%	1230	910
	2020E	1100	1165	6%	1265	885
	2021E	1160	1200	3%	1300	890
	2022E	1200	1225	2%	1325	915
	2023E	1218	1225	1%	1325	915
	LT (real)	1080	1080	0%		

Source: UBS forecasts

Gold

PIVOTAL QUESTIONS

Q: Is gold still considered a safe-haven asset?
We think gold's 'safe-haven' status remains broadly intact. However, headlines on geopolitical risks and uncertainty are unlikely to result in sustained gold upside – there needs to be an expectation of lasting effects on the economy. Gold's safe-haven role is likely to become more evident as investors seek protection from uncertainty associated with an anticipated economic downturn, such as soft patches in economic data; a more prolonged and pronounced selloff in equities; a dovish shift in monetary policy, particularly in the US; or rising concerns about systemic risks.

Q: What factors are likely to encourage sustained investor interest?
Interest in gold was limited for most of 2018, emerging tentatively only in Q4 as equities came under pressure and volatility picked up. Gold struggled given a backdrop of higher rates, dollar strength and an overall positive outlook on the US economy and equities. Despite some early signs of improvement in gold's appeal as a safe haven, scepticism lingers. Sustained performance is needed for investors to be convinced, in our view – we would look for a persistent negative correlation between gold and equities, as well as resilience to dollar strength and higher rates.

Q: Where is the balance of risks?
We like gold's risk-reward as a portfolio diversifier and hedge against uncertainty as the cycle matures. Continuation of Fed tightening, as economic growth holds up and equity returns remain positive, is likely to act as a drag on gold prices. The dollar's role as a safe haven would also continue to dampen some of gold's appeal. We view these pressure points as opportunities to gradually build strategic gold positions. Much is already priced in, reflected in lean positioning and relatively range-bound prices.

UBS VIEW

Gold is likely to stay within a broad range. We remain neutral on gold, expecting prices to stay range-bound, with a gentle drift higher over our forecast period to 2023. Bouts of equity weakness and potential soft patches in US growth offer upside opportunities for gold; however, a material shift in expectations for both, which triggers anticipation of accommodative monetary policy, is needed for gold to embark on a strong bull run. The downside should also be contained as gold remains a relevant asset for diversification and hedging risks. We expect strategic investors to take advantage of price fluctuations to gradually build positions.

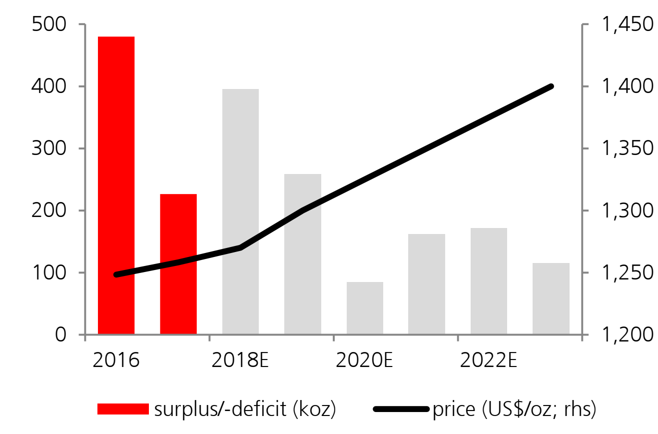
EVIDENCE

USD has become a more significant driver this year, but influence of rates still matters. Gold largely tracks the US dollar and rates, with the former a key headwind in 2018. Strategic interest remains subdued given fundamentally unchanged macro outlooks, but recent market volatility has directed some attention to gold. Extreme positioning and resilient core physical demand offer support.

SIGNPOSTS

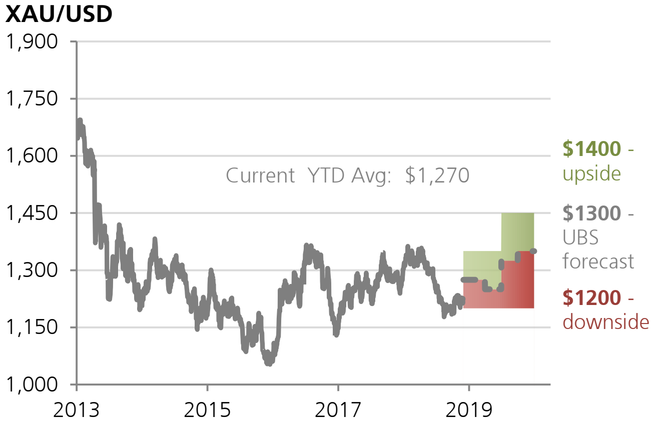
Factors affecting USD, real rates, and the level of macro uncertainty remain important. Fed policy and the trajectory of US and global growth are key determinants of gold's path. Correlations with equities, the dollar and rates are key indicators of gold's role. Speculative positioning provides clues on market bias and potential tactical opportunities. Physical demand signals determine the degree of support.

Figure 2: Price & supply/demand balance



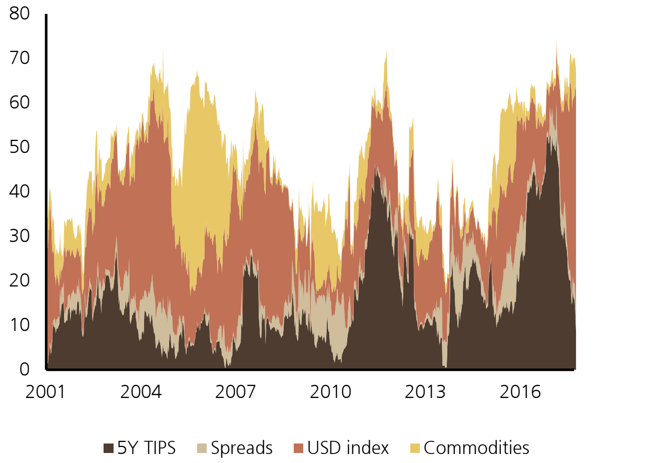
Source: Thomson Reuters GFMS, WGC, UBS

Figure 3: Upside/downside, 2019E (US$/oz)



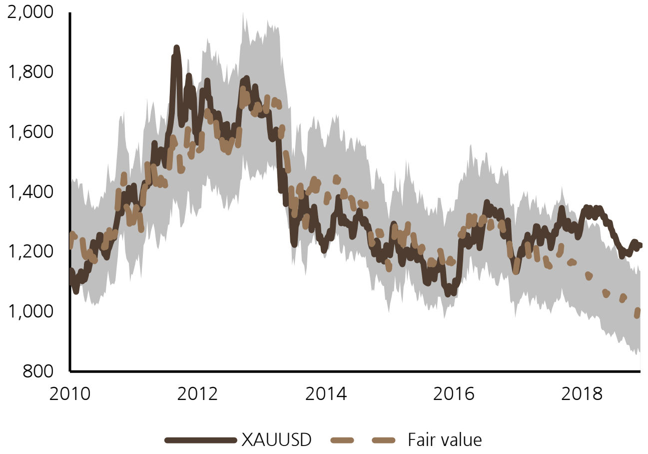
Source: Bloomberg, UBS

Figure 4: % variance of gold explained by each factor



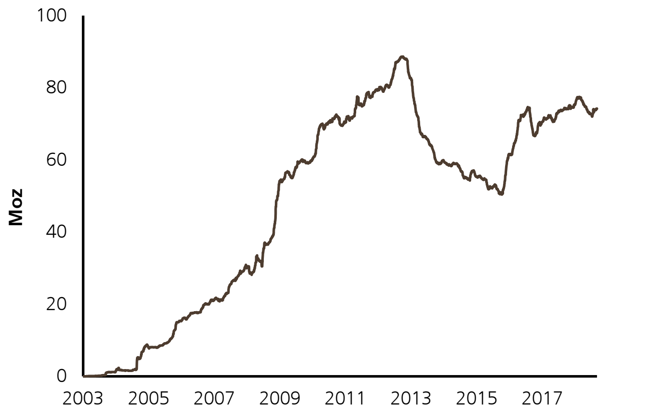
Source: UBS calculations

Figure 5: Gold short-term fair value model



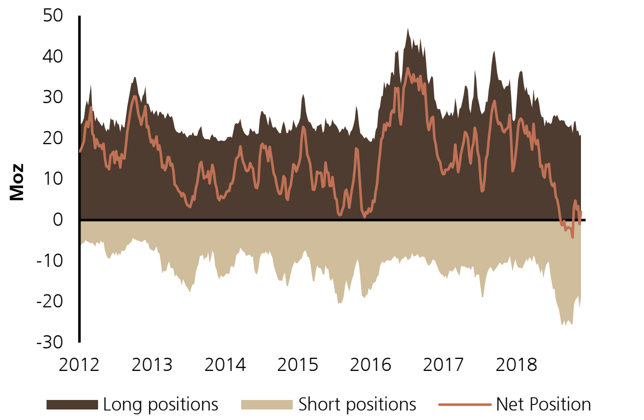
Source: UBS calculations

Figure 6: Gold ETFs, moz



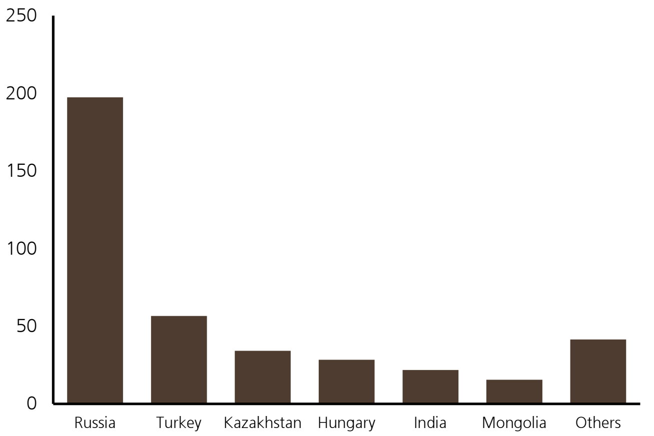
Source: Various ETFs, UBS calculations

Figure 7: Gold speculative positions on Comex



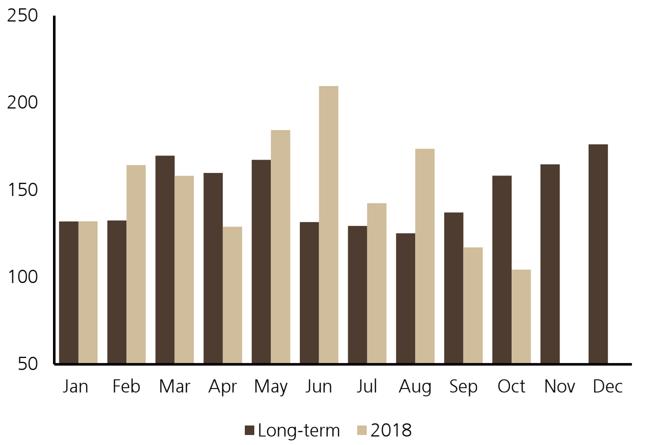
Source: Bloomberg, CFTC, UBS

Figure 8: Top central bank buyers, tonnes



Source: Bloomberg, IMF, WGC, various reports, UBS

Figure 9: China & India gold imports, tonnes



Source: Bloomberg, HK Census and Statistics Department, UBS

Silver

PIVOTAL QUESTIONS

Q: What drives silver performance?
Silver has been underperforming its peers for some time, with the gold:silver ratio touching multi-year highs, and we don't think conditions are likely to change soon. Silver is getting pressure on two fronts: 1) the drag from gold as trade tensions boost the dollar; and 2) the drag from broader commodities given downside risks to global growth on the back of rising trade tariffs. We think silver should continue to struggle given generally range-bound gold prices and a lack of a strong fundamental catalyst. Silver needs a strong gold bull-run and/or a compelling fundamental catalyst to revive interest.

Q: Do fundamentals matter?
Industrial applications account for more than half of total silver demand, while about 20% comes from jewellery. It therefore does not come as a surprise that despite being closely linked with gold, silver has also been closely following developments in industrial metals. An expected slowdown in growth and further downside risks given higher tariffs would impact demand. But ultimately price action tends to be driven more by investor sentiment, and we think a large part of silver's underperformance is on the back of poor investor interest.

Q: Is the uptrend in the gold:silver ratio likely to extend?
We lower our 2019 forecast to $15.8 from $17.0, following adjustments we made to gold and given the expectation that conditions are likely to remain challenging for silver. We cannot rule out periods of further upside in the gold:silver ratio, but we expect the trend to eventually move in silver's favour, albeit gradually. Although lower growth could weigh down on silver industrial demand, this should be offset by an improvement in investor interest to the extent that an economic soft patch benefits gold, which would consequently drag the entire complex higher. We therefore anticipate a moderate recovery in silver's relative performance to gold over our forecast period towards the mid-70s, where we expect the ratio to settle in the long-term. We find that the gold:silver ratio around these levels is consistent with previous periods when gold prices were broadly neutral.

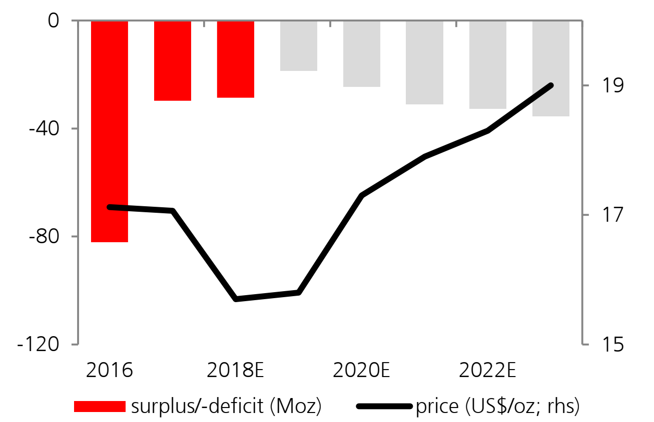
UBS VIEW

Silver interest is likely to remain subdued as long as gold stays within a broad range and risks to growth linger. We expect silver to continue being driven by gold price action. Participation has been subdued amid a lack of 1) a significant fundamental catalyst; 2) a shift in the macro landscape to materially alter gold's path; or 3) a considerable pick-up in volatility to attract more trading activity.

EVIDENCE

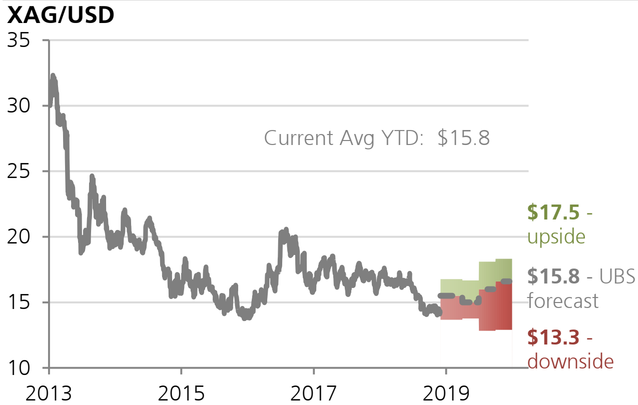
Interest in silver tends to be more speculative. Price underperformance, lacklustre gold prices and pressure on broader commodities have been weighing on sentiment participation. Silver positioning on Comex has generally been dominated by shorts, ETFs are down, and retail investor interest is weak.

Figure 10: Price & supply/demand balance



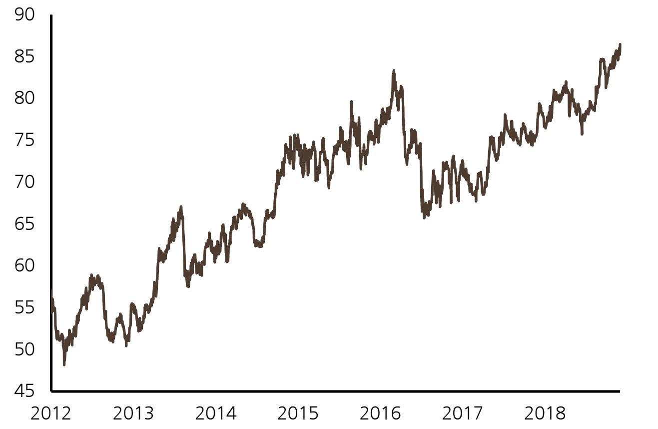
Source: Thomson Reuters GFMS, Silver Institute, UBS

Figure 11: Upside/downside, 2019E (US$/oz)



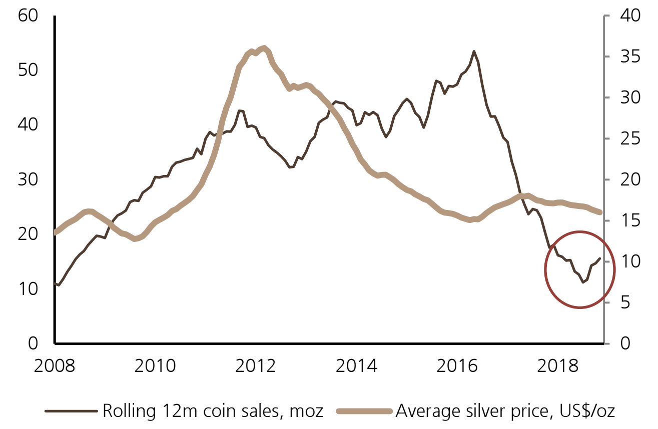
Source: Bloomberg, UBS

Figure 12: Gold:silver ratio



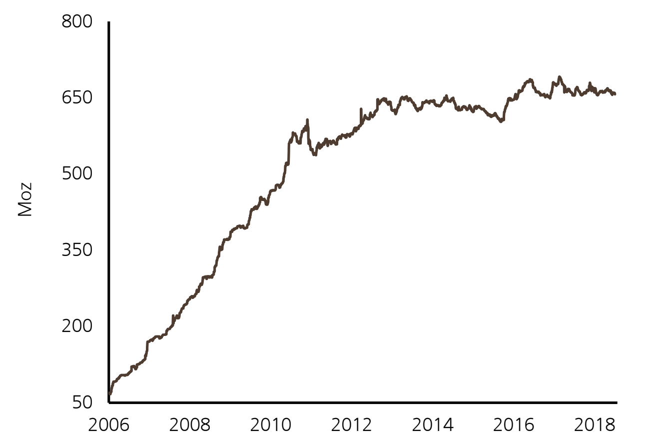
Source: Bloomberg, UBS

Figure 13: US Mint American Eagle silver coin sales



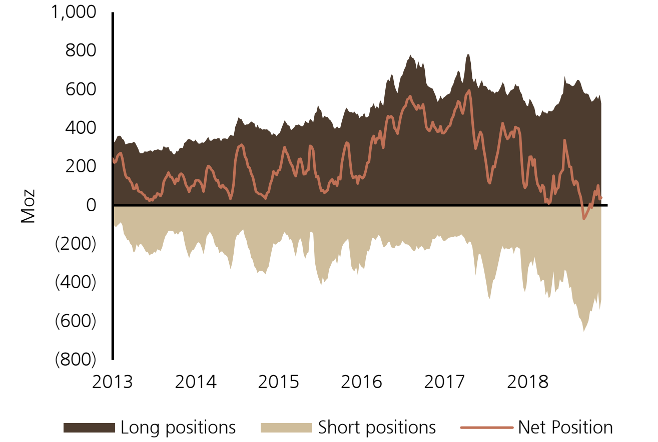
Source: US Mint, UBS

Figure 14: Silver ETFs, moz



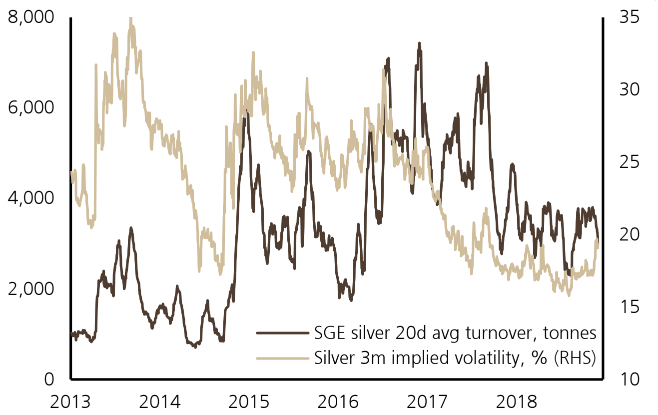
Source: Various ETFs, UBS calculations

Figure 15: Silver speculative positions on Comex



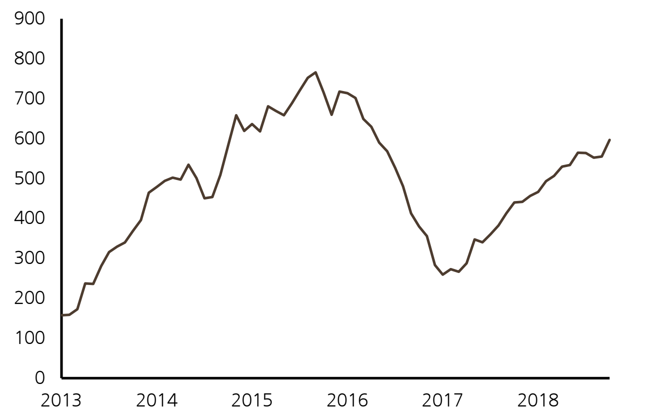
Source: Bloomberg, CFTC, UBS

Figure 16: SGE silver trading volume vs 3m implied volatility



Source: Bloomberg, SGE, UBS

Figure 17: India silver imports (12m avg), tonnes



Source: Bloomberg, UBS

Platinum

PIVOTAL QUESTIONS

Q: Is platinum demand likely to recover?
Platinum demand is likely to stay weak, with the two largest components remaining under pressure. Automotive demand should continue to fall as diesel shares persistently decline. This year, weak jewellery demand was driven by China. Although there's scope for improvement in 2019, risks to global growth and potential implications of lingering US-China trade tensions on consumer sentiment could limit this potential. A poor demand picture drives persistent surpluses in the platinum market over our forecast period to 2023. We think there is potential for substitution, particularly if the market reaches a point of prolonged wide price gap between platinum and palladium and significant concerns about supply sustainability of the latter. This is an upside risk to platinum demand, but there is currently no compelling evidence that platinum substitution is taking place nor any visible signs of improvement in demand.

Q: Can supply adjust and support prices?
Supply is likely to remain constrained, yet resilient. Underlying issues in South Africa's platinum mining sector persist, but the bar remains high for any meaningful reduction in supply. Despite poor platinum prices, the overall PGM rand basket prices remains elevated owing to strength in the rest of the platinum group metals and overall currency weakness. There could be downside risks to SA supply ahead, given rationalisation/consolidation in SA production. However, given market scepticism on the scope for producers to materially adjust output, a significant catalyst is likely needed to move the needle for platinum prices. We forecast a modest recovery in global supply next year, and declines towards the end of our forecast period.

Q: Where is the balance of risks?
We further adjust our platinum price forecasts, following changes we made to gold recently. Given a frustrating fundamental backdrop, we find that gold tends to be an important driver of platinum's path. Despite these downgrades, we maintain a rising price profile as a drift higher in gold is likely to drag up the entire complex. Given weak market sentiment towards platinum and limited positioning, the reaction to any substantial production disruptions/declines or a significant improvement in demand could result in an asymmetric move to the upside. However, current conditions suggest that there is a high threshold for this, with options pricing implying more downside concerns.

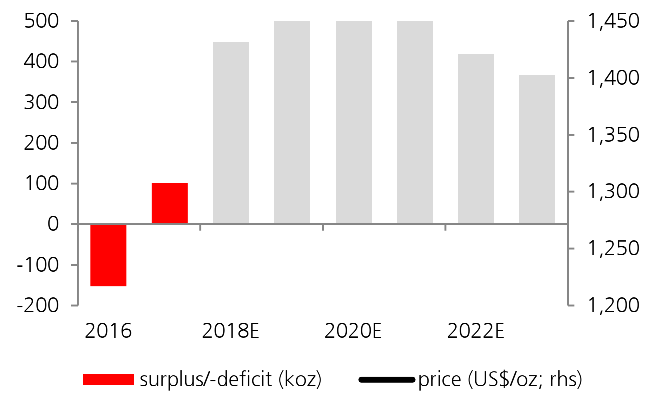
UBS VIEW

Platinum support mostly comes from its correlation with gold, but fundamentals remain challenging, ultimately limiting the upside. Underperformance should remain in place given the fundamental outlook, but there prices should recover from the lows, likely to be dragged higher by gold. There could also be some value trades in platinum to some extent, considering that prices have fallen to levels last seen during the recession.

EVIDENCE

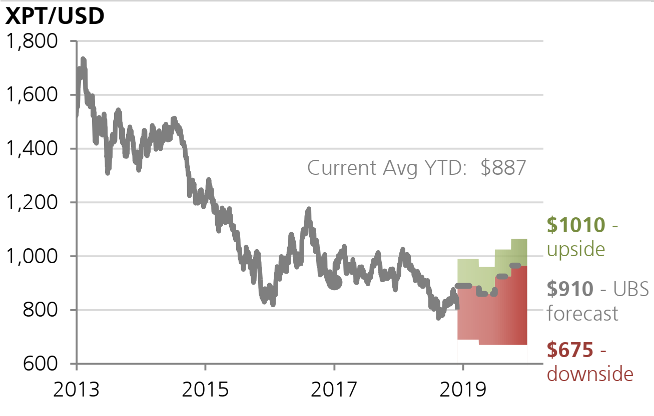
Our model shows that gold is a key driver for platinum prices. This is likely to continue given the lack of a compelling fundamental story. Demand remains weak, resulting in a market surplus, despite constraints on supply. Therefore, although there is scope for upside in platinum from current levels, it is hard to justify an overly bullish view.

Figure 18: Price & supply/demand balance



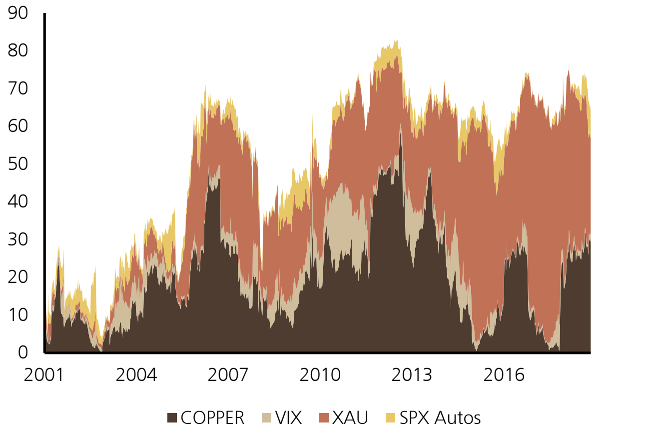
Source: Johnson Matthey, UBS forecasts

Figure 19: Upside/downside, 2019E (US$/oz)



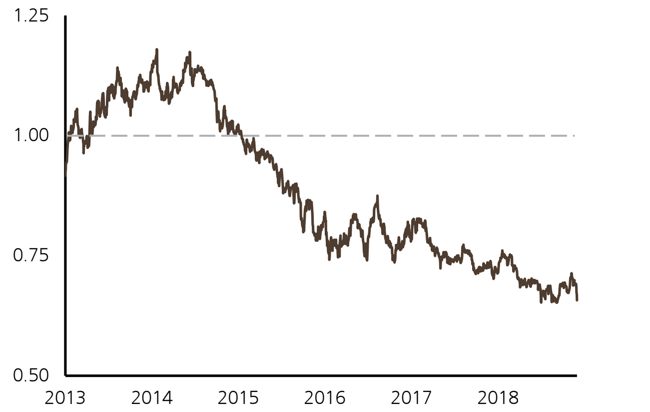
Source: Bloomberg, UBS forecasts

Figure 20: % variance of XPT explained by each factor



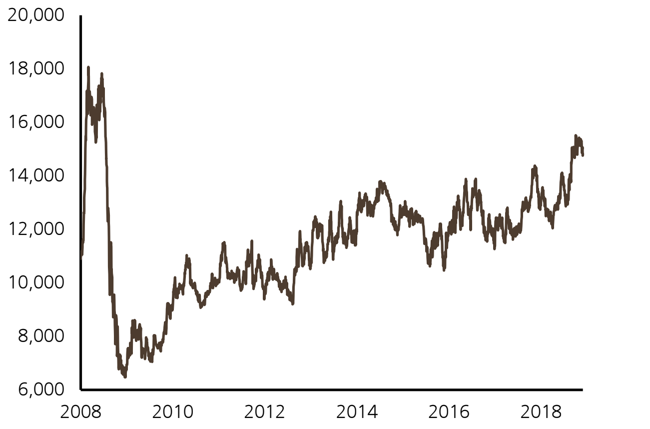
Source: Bloomberg, UBS estimates

Figure 21: Platinum:gold ratio



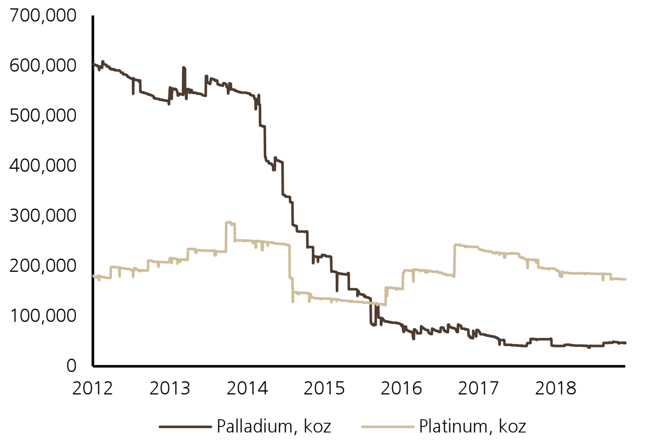
Source: Bloomberg, UBS

Figure 22: PGM rand basket price



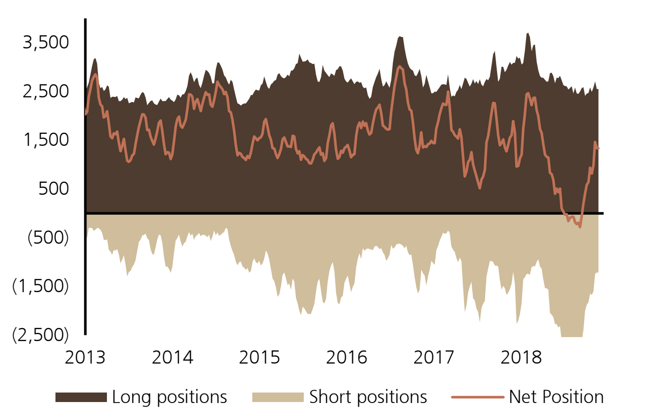
Source: Bloomberg, UBS

Figure 23: Platinum vs palladium Nymex inventories, koz



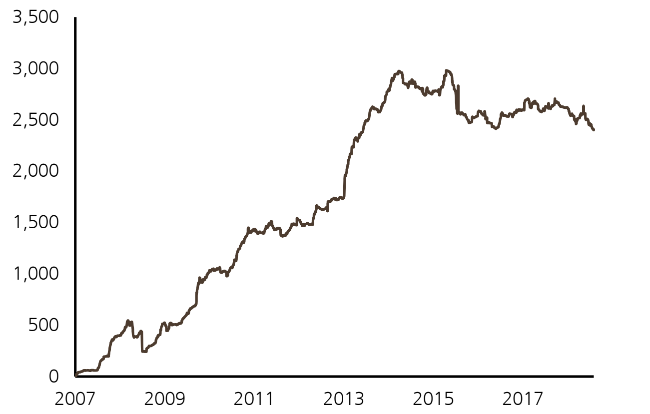
Source: Bloomberg, Nymex, UBS

Figure 24: Platinum speculative positions on Nymex, koz



Source: Bloomberg, CFTC, UBS

Figure 25: Platinum ETFs, koz



Source: Various ETFs, UBS calculations

Palladium

PIVOTAL QUESTIONS

Q: Is the palladium market tight?
We expect the market to remain in deficit to 2023, supporting an uptrend in prices. Fundamentals are strong and indicators suggest that the market is tight and getting tighter. Forwards remain in backwardation suggesting some resumption of tightening in Q4. Nymex inventories are considerably lower. ETFs have been selling – whether outright or to take advantage of backwardation in the market. HK net imports suggest robust demand out of Asia, which coincides with growth in China's auto market and higher loadings given tightening emissions standards. Flows through Switzerland are much more subdued. Having said this, we think it is important to watch car sales in China given recent weakness and potential downside risks as trade tensions escalate vs possible stimulus.

Q: Do macro and geopolitical risks matter more than fundamentals?
Fundamentals provide the market with a strong backdrop. But risks from rising trade tensions and slower growth cannot be ignored either given potential downside auto sales, with nearly 80% of palladium demand coming from the auto sector. Our model shows that copper prices have a considerable influence on palladium, suggesting that weakness across broader commodities could exert pressure. Palladium could also be dragged lower during bouts of risk-off, given palladium's strong positive correlation with equities, amplified by challenging liquidity conditions. Nevertheless, tight supply should keep the market supported despite these risks. Dips are likely to be bought, keeping the broader uptrend intact.

Q: Are the risks balanced?
We raise our palladium forecasts across the board, moving towards our previous upside scenario, given compelling fundamentals and strong investor interest. Moves in either direction are likely to be amplified by liquidity issues, resulting in a choppy journey higher. Supply risks are likely to have a strong price impact on a market that is already perceived to be tight – robust fundamentals could mean that SA supply issues would be reflected more in palladium prices rather than platinum. On the other hand, periods of risk-off and pressure on broader commodities, could result in more of a drag to palladium prices, despite relatively unchanged fundamentals, given large exposure to the auto sector and high correlation with equities.

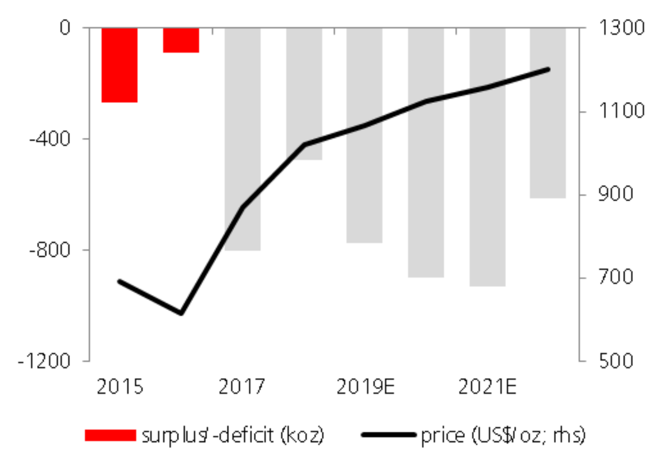
UBS VIEW

Fundamentals should underpin palladium's long-term uptrend, albeit with scope for interim volatility. We are bullish on palladium, expecting prices to continue rising as fundamental factors remain in focus. Bouts of risk-off could weigh on the market from time to time, especially given thinner liquidity conditions. We think dips should ultimately be viewed as strategic buying opportunities.

EVIDENCE

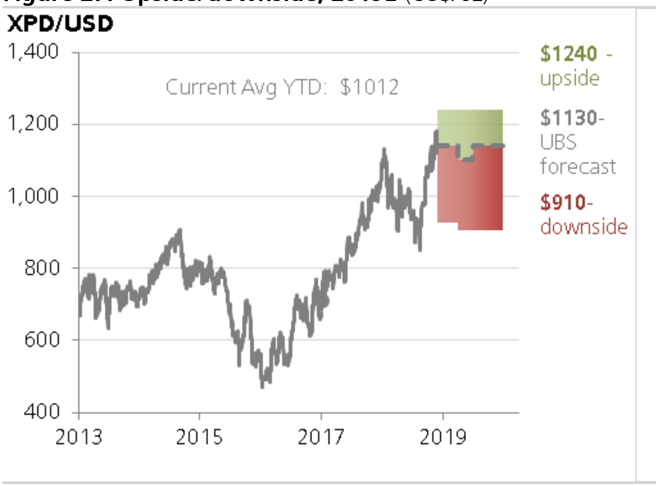
Signs of market tightness are evident. Palladium forwards remain in backwardation. Net imports to HK have been rising in the last several years, coinciding with growing palladium demand. ETFs remain heavy sellers, bringing global holdings back to levels last seen in about a decade. Low inventories and price spikes are raising concerns about sustainability of supply. Significant escalation in these concerns could strengthen the argument for substitution, but there is no strong evidence of this yet.

Figure 26: Price & supply/demand balance



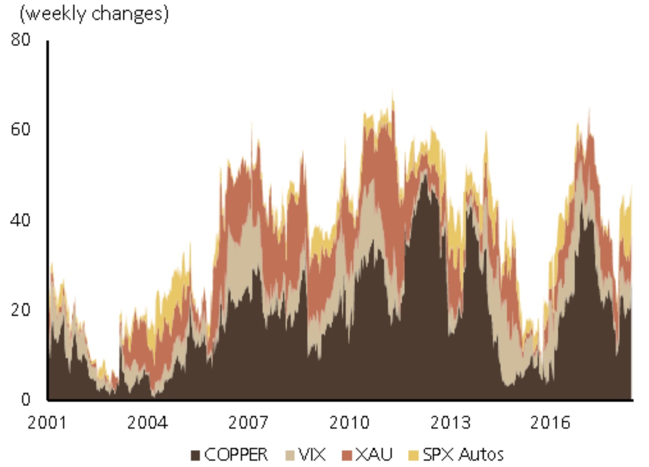
Source: Johnson Matthey, UBS

Figure 27: Upside/downside, 2019E (US$/oz)



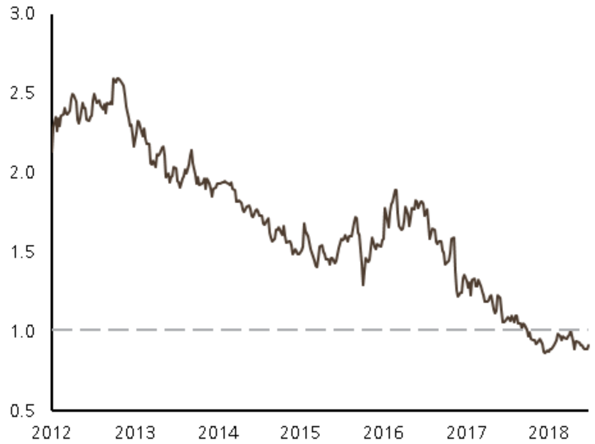
Source: Bloomberg, UBS

Figure 28: % variance of XPD explained by each factor



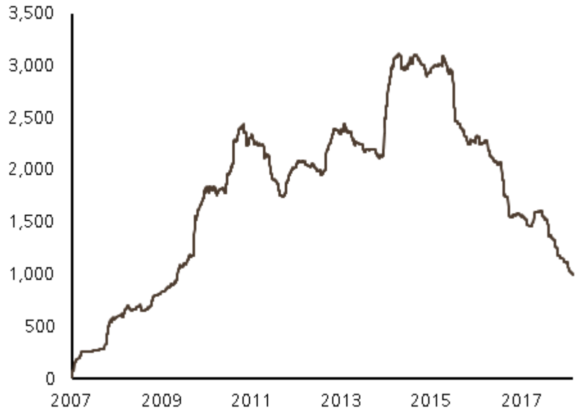
Source: UBS calculations

Figure 29: Platinum:palladium ratio



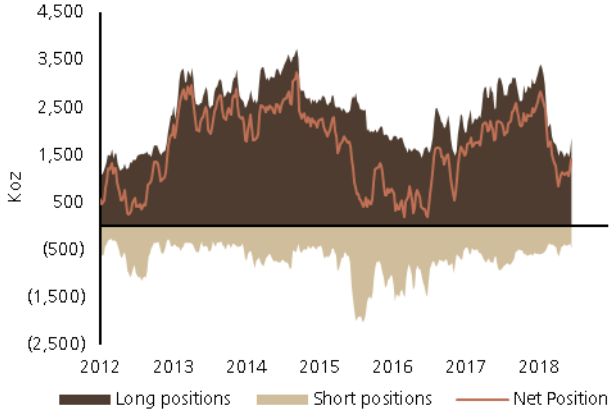
Source: Bloomberg, UBS

Figure 30: Palladium ETFs, koz



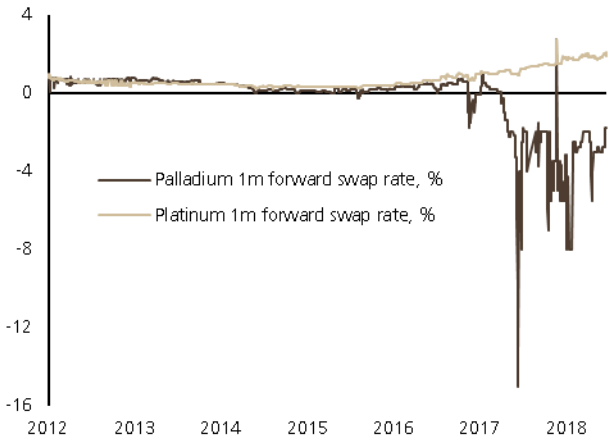
Source: Various ETFs, UBS

Figure 31: Palladium speculative positions on Nymex, koz



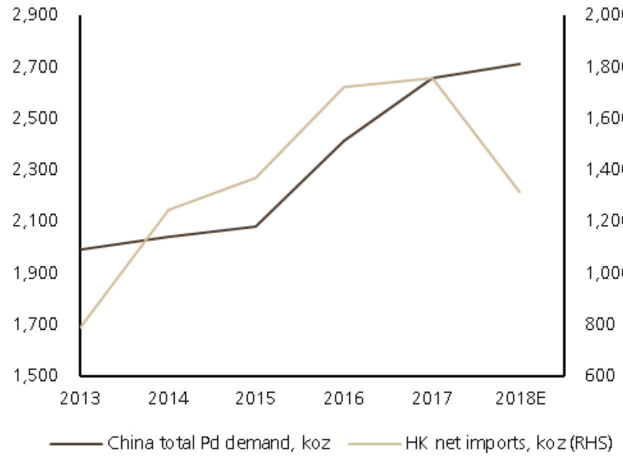
Source: Bloomberg, CFTC, UBS

Figure 32: XPD vs XPT 1m forward swap rates, %



Source: Bloomberg, UBS

Figure 33: HK palladium imports vs China demand, tonnes



Source: Bloomberg, UBS

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