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Spotlight shines on gold and silver as Fed hits pause button

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Global markets went quiet ahead of the long awaited Federal Open Market Committee meeting this past week as the first rate hike in almost ten years seemed possible. In the end Janet Yellen and her fellow central bankers opted for no change and the statement following the announcement was surprisingly dovish.

While US activity and employment data remains strong the extreme market volatility in late August and developments in commodities and the Chinese exchange rate policy distracted and alarmed the Fed sufficiently to tilt their preference to sitting on their hands for now.

When the FOMC is worried about economic developments outside the US, especially in China and other EM countries, it raises some concerns about the near-term outlook for demand of growth-sensitive commodities such as energy and industrial metals.

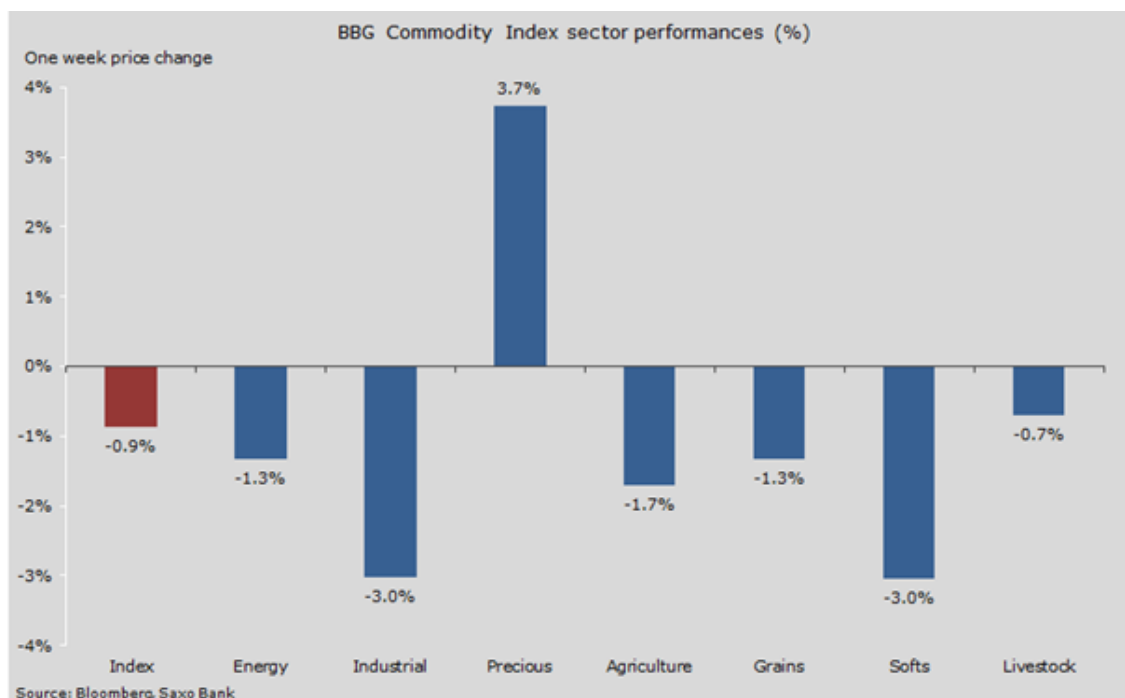
The market reaction was therefore not entirely surprising with precious metals once again receiving a bid while industrial metals gave back some of the recent strong gains. The energy sector was mixed with WTI crude oil outperforming Brent by quite a margin following a surprise drop in US inventories together with an overhang of supply from the Atlantic basin.

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Silver was the star performer of the week after the break of a key technical level saw it outperform gold by almost two percent. The white metal, to the surprise of many, is currently the second best performing commodity in 2015 after cocoa which has resumed its rally as dryness continue to hurt West African crops. In a report, the World Bank sees the risk of an expanding global deficit for the 2015-16 season as the looming El Niño could trigger significant losses in West African yields.

Industrial metals, not least zinc and nickel went into reverse after the Fed's delay signaled concern about growth prospects in EM countries. HG copper retraced after having rallied by more than 13% since the August low and the risk of a resumption of weakness has increased.

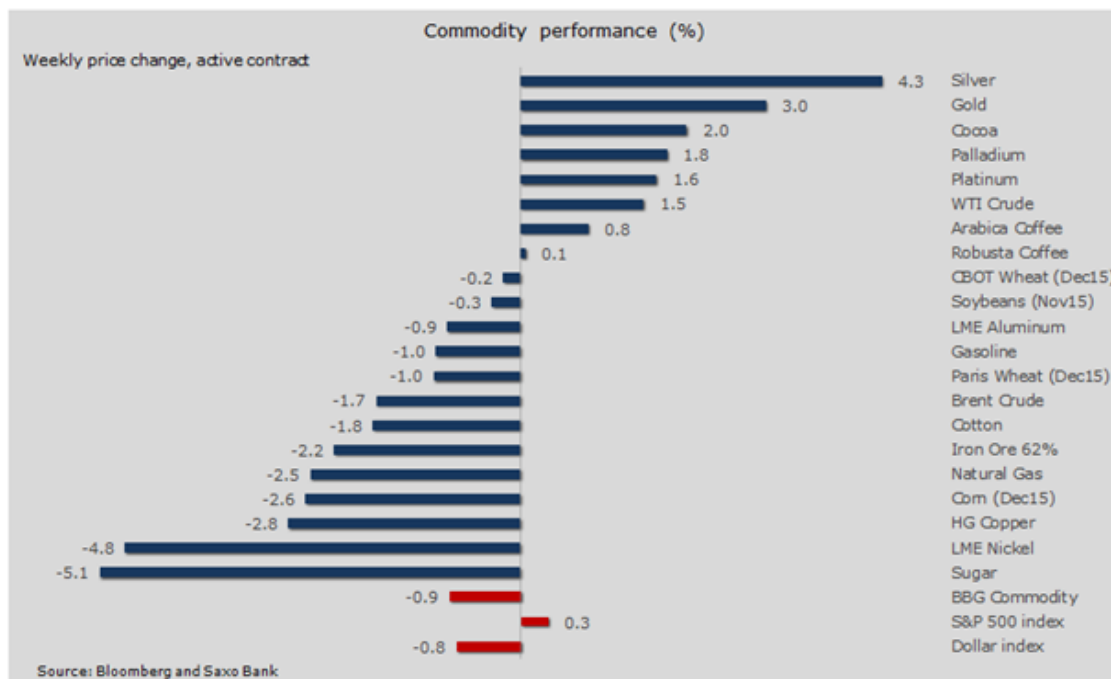
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WTI crude once again found support above \$43 before receiving a boost from the bullish inventory report Wednesday. In it the Energy Information Administration (EIA) reported a surprise drop of nearly 2 million barrels at the key delivery hub for WTI crude oil futures at Cushing, Oklahoma. Adding to this a second week of lower imports and lower production combined with a pick-up in refinery demand, the price had nowhere to go but higher.

The short-term outlook for crude oil generally has been negative on the assumption that the annual slowdown in refinery demand from September to November would lead to surging inventories. Although we are just about getting into this season, the latest data failed to support this expectation and it supports the view that oil is settling into a mid-40s range.

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WTI crude oil settling into a range as US supply drop outweighs Fed's growth concerns



Source: www.saxotrader.com

Brent crude on the other hand failed to keep up as a strong loading programme for October from the Atlantic basin which include the North Sea and Nigeria will hit the market at a time where European refinery demand slows due to seasonal maintenance.

These developments, combined with continued attempts from US lawmakers to revoke the 40-year old export ban, have triggered a spread contraction between the two benchmarks to the lowest since January. A removal of the export ban would make US crude available to the rest of the world thereby increasing competition between producers and ultimately it could see WTI crude oil's premium over Brent being reinstalled.

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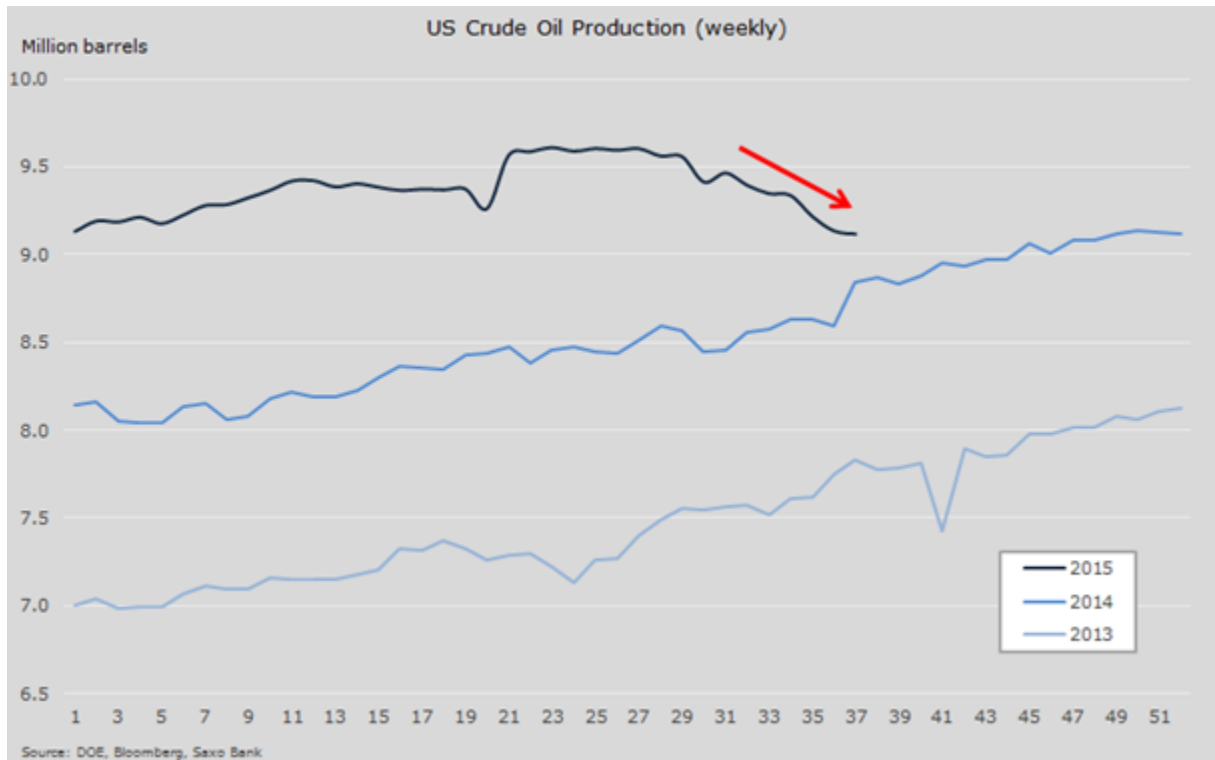
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US oil production is slowing but will it be fast enough to offset rising Opec supply?



The prospect of Iranian oil hitting the market within the next six months, combined with the new worry about EM growth and demand prospects, means the near-term outlook for oil remains challenging. The focus on the current oversupply will not go away any time soon and this leaves the price risk skewed to the downside. Non-Opec production led by the US is slowing but as both the EIA and Opec said in recent reports the positive price impact of this will first be felt during the latter part of 2016.

Gold and especially silver received a boost from the Fed's decision to hold US rates unchanged, at least for another month. Speculative short positions were covered once again just like in August when the Chinese devaluation triggered renewed demand for alternatives such as gold. Having managed to find support earlier than during the July sell-off the key to further progress will be determined by the metals ability to break the August high at \$1170.

Such a break would from a technical perspective give an early indication that a low has been established. However until such time and with the uncertainty of the timing of when Janet Yellen

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eventually will pull the rate hike trigger the upside seems limited at this stage. Not least considering the continued lukewarm attitude to gold from paper investors such as hedge funds and money managers.

The physical market on the other hand has been showing signs of life and demand. India's gold imports reached \$4.96 billion during August which was up 140% y/y. That equates roughly to 138 tonnes of gold or the equivalent of the last 6 months redemptions from exchange traded funds back by gold. Russia's gold reserves rose by 1 million ounces during August which is another big number.

Silver, however, was the star performer with the break above the key \$15 level triggering renewed buying interest. The ratio to gold (which measures the cost of one ounce of gold in ounces of silver) dropped to 74 from an August high at 80, a 7.5% outperformance in three weeks. Just like gold, a break of the August high at \$15.67 would attract some additional technical buying.

Silver looking for next level of resistance after having broken above \$15



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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income to commodities. He previously worked for 15 years in London, most recently for a multi-asset Futures and Forex Hedge fund, where he was in charge of the trade execution team. He is available for comments on most commodities, especially energies and precious metals.

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