

## COMMODITIES: OIL SLIDES ON DEMAND-SUPPLY IMBALANCE, GOLD SUFFERS FROM RISK-ON. WE TURNED NEUTRAL OIL AND UNDERWEIGHT GOLD.

**Lionel Melin**

Strategist

lionel.melin@lyxor.com

**Jeanne Asseraf-Bitton**

Global Head  
of Cross Asset Research

jeanne.asseraf-bitton@lyxor.com

**Jean-Baptiste Berthon**

Senior Strategist

jean-baptiste.berthon@lyxor.com

**Philippe Ferreira**

Senior Strategist

philippe.ferreira@lyxor.com

**Anne Mauny**

Research Analyst

anne.mauny@lyxor.com

**Oil prices seem to have slid in the wake of Greek and Chinese concerns further fueled by the G5+1 accord with Iran that could deliver more supply into the market rapidly.**

**Our quarterly target on oil prices is reached and we have switched to a neutral stance**

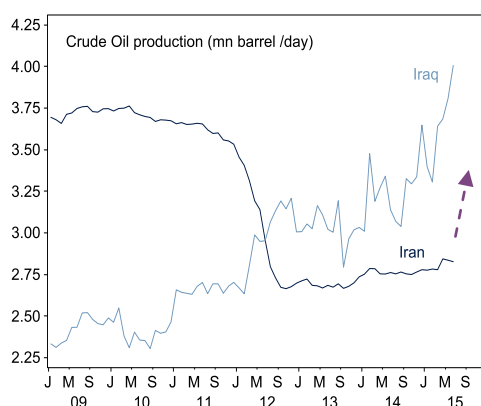
- The geopolitical truce could let Iran follow Iraq's path and sell a lot more oil shortly
- US refining on its end appears to have a hard time processing all the accumulated crude oil reserves, while shale gas producers may have cut cost enough to survive.
- While we are foreseeing global demand to eventually pace up (led by improving developed markets dynamics) we think that supply will swallow any price impact.

**Gold prices appear to have faltered abruptly post the PBoC release of bullion holdings far lower than expected, a few days after the Fed re-affirmed that its normalization cycle shall start by year-end.**

**We think that a risk-on environment could weight further on the precious metal and recommend being underweight.**

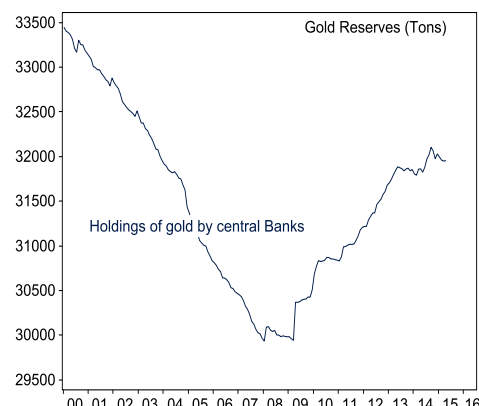
- Gold is facing multiple headwinds: curbed Chinese and Indian private demand, reduced central banks appetite for gold reserves, and an environment turning less risk averse while inflation is far from requiring hedging.

### Iran could resume production swiftly



Source: Macrobond, Lyxor AM

### Central banks gold reserves are plateau-ing



Source: Macrobond, Lyxor AM

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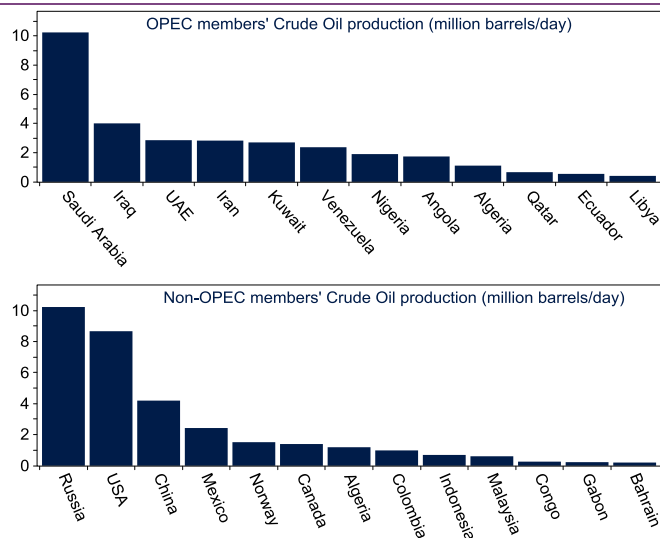
## OIL GLUT... CONTINUED

### The accord with Iran could open the flood gates in the coming months

Iran is currently producing less than 3 million barrels a day, but has been mentioning a medium term target of production resumption to the vicinity of 5 million barrels. If drawing a parallel with the resumption of production monitored in Iraq lately, we think that such an aim may be manageable.

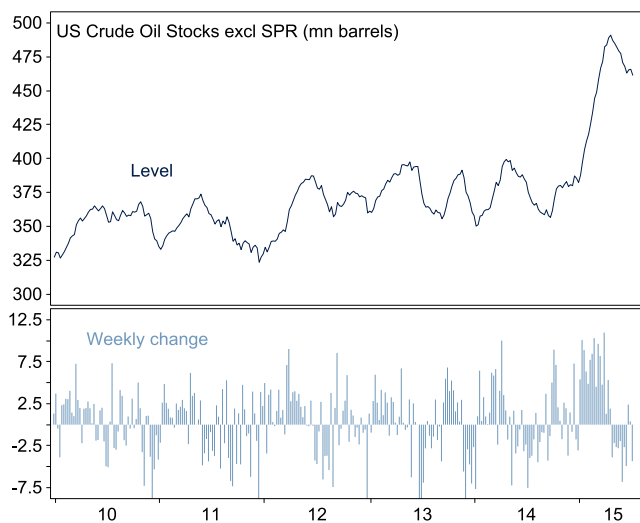
In turn, we expect some un-easiness from Saudi Arabia on geopolitical grounds (in the Sunni versus Shiite face up) that could foster even more production to be put in the market.

### Global oil production has a few key players



Source: Macrobond, Lyxor AM

### US crude oil stocks remains elevated

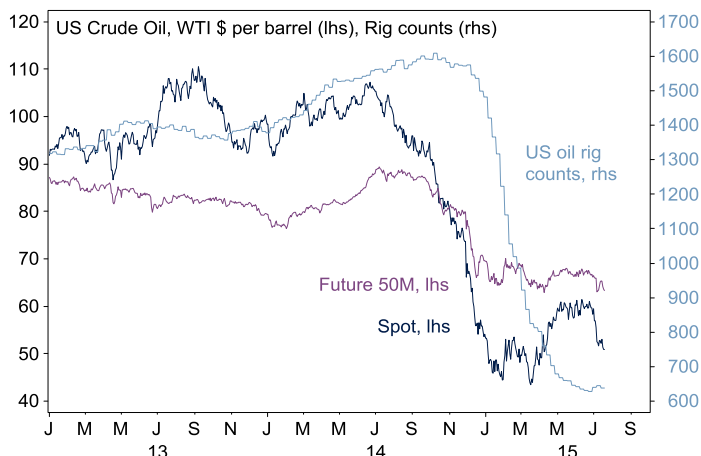


Source: Macrobond, Lyxor AM

### US production and stocking does not seem to reach a halt

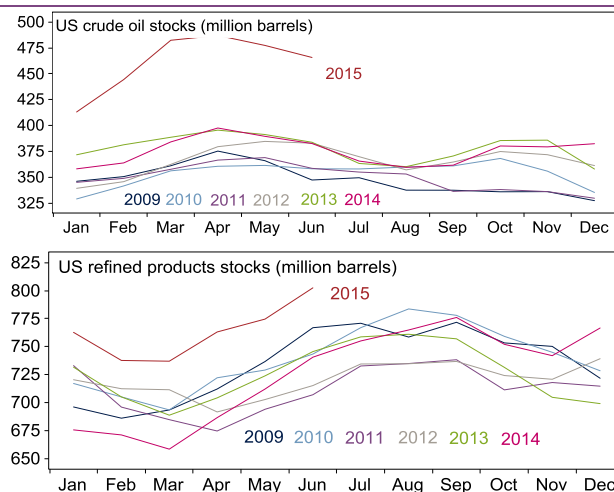
Meanwhile, US production may have found a new lease for life with shale oil producers having cut costs quickly and drastically. US oil rig counts even ticked up – very modestly – in July.

### Contango has rebuilt and a few rigs have tempted to be added



Source: Macrobond, Lyxor AM

### US refining remains far from absorbing the excess



Source: Macrobond, Lyxor AM

The latest slide in prices has also mostly affected spot prices, and rebuilt some contango in the WTI curve, so that incentives are back on the table for further reserves to be accumulated and production not to be clamped down further.

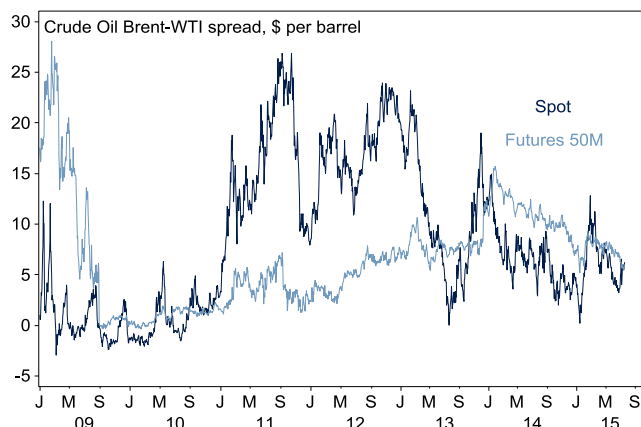
### Refining arbitrage cannot correct the supply glut

As hinted by crude oil reserves not dwindling promptly, US refining is having a hard time absorbing the extreme stock levels. Beyond US borders the price-differential opportunity between Brent and WTI has even triggered a vast arbitrage dynamics (with refined products being exported to more expensive Brent-supplied regions) which keeps the latter (Brent versus WTI) spread range-bound. At the moment, the increase in supply could actually put both regions on the same footing with both the US and OPEC countries capable of flooding the market.

### Global demand is still to pick up

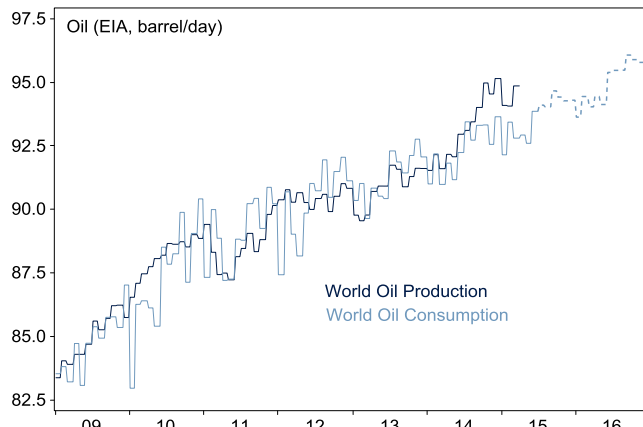
The new leg of oil slide ignited two weeks ago was fostered by acute concerns about global growth in the wake of the Chinese bond rout and Greek brinkmanship. These heightened worries underline the current unbalance where demand for energy remains hesitant in a context of very weak global economic improvements.

### The Brent / WTI spread has only mildly widened lately



Source: Macrobond, Lyxor AM

### Demand and Supply still unbalanced



Source: Macrobond, Lyxor AM

## DEMAND-SUPPLY BALANCE HAS US NEUTRAL ON THE BARREL

We remain positive on the recovery potential of global demand in the months to come (spearheaded by a potential upturn in developed markets), but we think that further supply glut could swallow a would-be uptick in prices.

The main risk to keep in mind – would supply vastly overtake demand, and the oil slump rekindle – would be that deflation scares could knock at the door once again.

We also highlight two key threats with current oil prices. First, these levels are far below the breakeven prices that would allow most producing countries to balance their government budgets, and hence risk triggering instabilities in key EM markets. Second, US high-yield credit is vastly exposed to a hefty presence of oil producers (they would account for 15-20% of issued papers). Forced restructuring or outright default on loans contracted for capital investment purposes during the shale gas run by these companies would hurt the asset class.

## GOLD PROSPECTS ARE NOT SHINING

The backdrop for precious metals in general, and gold in particular, has deteriorated.

### Central banks have stopped accumulating gold

According to IMF data, holdings of gold by Central Banks have been peaking. The post financial crisis appetite for bullion is receding as several central banks have already reached their target breakdown of foreign exchange reserves. This picture was highlighted on Monday 20 when the PBoC report of gold holdings at 1,658 tons (dramatically lower than consensus estimates of 3,500 tons) coincided with a flash crash of the precious metal market down to its lowest level since February 2010.

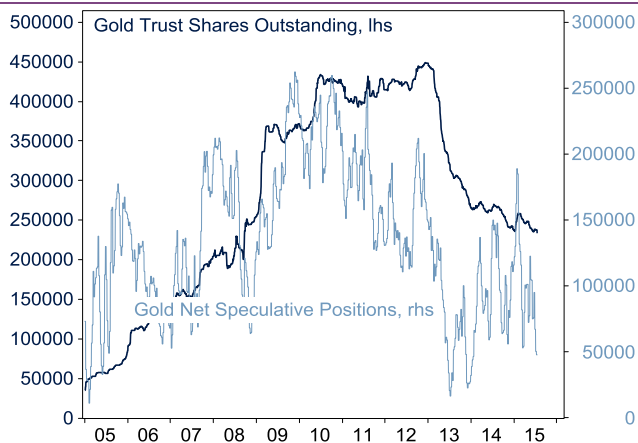
### Asian demand is fading

Trends on Chinese gold imports are weakening, impaired the ongoing crackdown on corruption (which makes vast use of the metal as means of transactions). Indian authorities on their end have lately been adjusting tariffs on gold in order to curb imports, a major source of current account deficit (gold is the second import in value for India after petroleum).

### Risk-on environment and Fed normalization

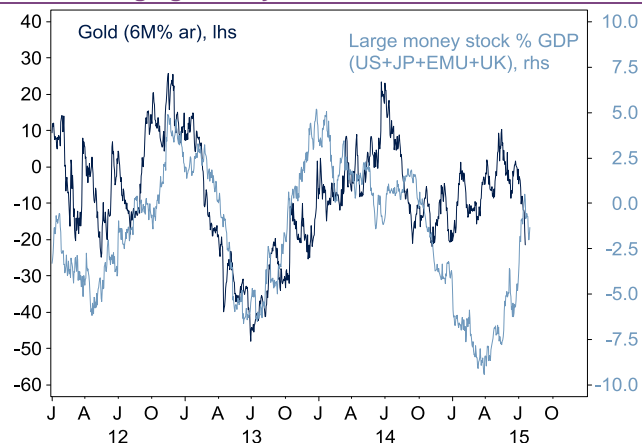
Last but not least, we think that gold is losing investment attractiveness as the macro backdrop is exiting its post-crisis deflationary mode: global growth is gradually recovering; the economic dynamics in the Eurozone and Japan seem to be improving; and the Fed will probably hike funding rates next September. This latter move could support some appreciation of the greenback, typically costly for the precious metal.

#### Investors losing interest for gold



Source: Macrobond, Lyxor AM

#### Money demand is recovering from such low levels that inflation hedging is not yet warranted



Source: Macrobond, Lyxor AM

## UNDERWEIGHT STANCE ON GOLD

We believe that gold prices are highly vulnerable to the risk-on window and the coming Fed's policy normalization, with potential USD appreciation and rising bond yields. We also think on the other hand that the current environment of perfectly benign – although grinding higher – inflation is still no support to gold as a refuge against inflationary threats.

We downgraded last month our long term view on gold from neutral to underweight and we emphasize this stance today.

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