

If the US Weakens Again, What Happens to Metals?

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The announcement of a surprisingly large US trade deficit for September had some assuming the US consumer is back in a buying mood. Alas, the much watched Michigan consumer confidence index for November quickly followed, and it is off a large 4.6 points, from 70.6 in October to 66.0 now. The import gains were largely for crude oil, and there was some gain from the “declunkering” auto sector. Even in weak markets there will be periods of restocking that have to be figured into single bits of data. Before Friday was done inventory levels for crude came out that were full enough to knock its price back from recent highs.

Chinese data indicates better than the astounding growth that had been expected, and Japanese data indicated stronger than expected growth. Europe is back in the black, though at sub 1% rates for the zone as a whole. Canadian trade data for September came out the same day as the US figures, and it surprised with only half the \$1.8 billion deficit that had been expected. There were somewhat higher exports to the US, but the real surprise was a very large percentage gain to Europe.

Increased trade between economies with strengthening currencies is likely to be volatile going forward as currency ratios move about. Those looking for a stronger greenback near term mostly assume that would be in conjunction with a weaker Euro. That makes sense given both economies can't see the end of the debt tunnel yet, but the players are realigning in ways that continue to bode uncertainty and the old “rules” of the currency game have not been working so well of late.

Talk of having the Yuan rise as part of rebalancing the trade picture is finally getting some nods from Chinese officials. It will happen at some point, and probably soon in a small way if China's economy continues its strong performance. When a larger move that would make its regional trading partners (and US senators) happy is still anyone's guess. There have been more recent comments about letting foreign companies issue Yuan denominated bonds. A small thing, but part of building the financial infrastructure necessary to move the Chinese currency from being a peg to a true market participant.

If **gold's** price gains are saying anything specific it's that a strengthening Yuan could be harder on the Dollar than anything else. The broader message is however that the currencies dance winners won't be known till the music stops. This is creating a market for the yellow metal as a neutral asset against all fiat currencies that we expect would largely be sustained even if the currency pairs roll over and the Dollar sees a gain. A consolidation of gold's price on a large uptick for the greenback should still be expected, but gold holders would be as interested in the yellow metal's value in their home currencies as in its trade against the Dollar, and that could steady its market. The Dollar has seen brief periods of strength in the past few sessions that have not led to anything like the gold selloffs expected by some. It's also of note that gold is now quite close to record highs in several other currencies, including the Euro.

The steadiness of **copper** and the other base metal prices continues to impress. While we continue to view this as part of the Dollar dance, there are more signs that sellers are

not worried about future markets. CODELCO, Chile's state owned and the sector's largest copper producer, has just indicated it plans to raise handling rates to China by 15%, or \$10 per tonne. Though not a large factor, it is evidence that CODELCO is getting more comfortable with the demand picture to Asia. News out of China on the environmental issues at lead-zinc smelters have quieted, but we doubt gone away. To this could be added a number of mine supply disruptions, but as noted in the Journal none is large enough individually to be large concerns per se.

While we are still expecting consolidation in base metal prices, we increasingly wonder if that wouldn't simply cause offers in the commercial stockpiles to begin disappearing. The same logic holds here as for the precious metals that local currency considerations will drive decisions about what price is too low to put metal into the market. If China does start incremental gains for its currency again that may only muddy the waters. Chinese metal holders would need to start thinking in terms of whether they could pay fewer Yuan at future date for the same amount of metal, which isn't an issue with the Yuan-\$ rate essentially fixed as it is now.

Cutting to the chase, we remain concerned by the currency equations that have become such a large part of metals pricing. Though base metal stockpiles remain at manageable levels they do continue to build, and we believe that is what should govern opinion about future pricing for the time being. We doubt there will be a large uptick for base metal stories before general economic stats indicate that broader global growth will continue, and are willing to wait for that. If the contrarian few that believe a bounce should be in the offing for the greenback are right, we would expect that to weigh more heavily on base metals than on gold. That would be a buying opportunity we'd look kindly on since our concerns about pricing are short term, not long term.

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