Standard Bank
Also trading as Stanbic Bank

27 June 2014

Slowly turning some ships around

Quarterly

Global | Commodities

- **Precious metals:** We expect gold and silver to struggle in H2:14, with the price risk to the downside. However, into 2015, we see the gold market better supported, especially if Indian demand should return. Our outlook for platinum this year is muted, with little upside in 2015. We remain below consensus on the outlook for platinum in 2014 and 2015. Price-wise, we see the most upside for rhodium, then palladium, within the precious metals basket.

- **Base metals**: We expect the aluminium market to enter a deficit in the next three years. Therefore, inventory will be drawn down and the market will increasingly rely on LME inventory – which may not necessarily be available – to satisfy demand. Demand growth is expected to come in at 3.7% this year before picking up to 4.4% in 2015. We have made few adjustments in our overall demand numbers for copper, and still see the price well supported, especially into the back end of 2015 despite small surplusses for copper in the next three years: 107kt in 2014, declining to an almost balanced market, with a surplus of only of 70kt in 2016. We have raised our copper forecast for 2015 by 6%. Nickel remains a dominant feature in the base metals complex. We expect the metal to average $17,526 this year, and $18,000 in 2015. Refined metal availability should cap upside beyond this level.

- **Energy:** Our view on crude oil remains largely unchanged, with Brent expected to average $108/bbl this year, up 2% from our previous forecast. Upside comes from potential supply disruptions from especially Iraq. However, we believe that OPEC should be able to compensate for any supply disruptions from Iraq and Libya. The outlook for thermal coal remains depressed. In fact, we have decreased our price expectations for API2, API4 and Newcastle coal in 2014.

- **Bulks:** In our view, fair value for Q3:14 iron ore prices lies in the $100-105/mt range. A seasonal re-stock, coupled with further mine closures for those unprofitable in the $100-110/t range, should see some of Q2's price dislocation, due to oversupply, correct. Beijing's various stimuli should also generate steel consumption support, particularly for infrastructure and social housing, noting that most new programmes will do little to assist property oversupplies, except in those few cities which have wound back home purchase restrictions.

Index

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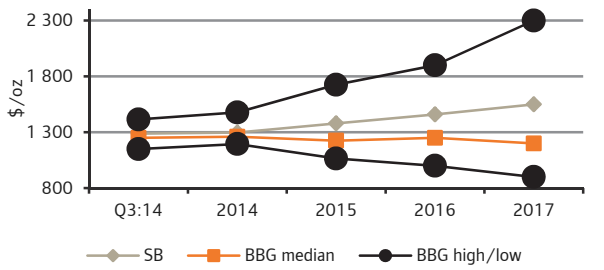
Commodity price forecasts

	2013	2014F	2015F	2016F	2017F	LT	Q2:14	Q3:14F	Q4:14F	Q1:15F	Q2:15F
PRECIOUS METALS ($/oz)											
Gold ($/oz)	1 412	1 298	1 380	1 460	1 550	1 460	1 280	1 287	1 330	1 330	1 360
(y/y %)		-8.1	6.3	5.8	6.2						
(% chg from previous forecast)		0.1	-	-	-	-		-1.0	-	-1.5	
Platinum ($/oz)	1 487	1 457	1 550	1 650	1 750	1 900	1 450	1 450	1 500	1 500	1 550
(y/y %)		-2.0	6.4	6.5	6.1						
(% chg from previous forecast)		-0.9	-10.1	-15.4	-15.2	-		-3.3	-	-3.2	
Palladium ($/oz)	720	788	875	900	950	900	813	795	800	800	800
(y/y %)		9.5	11.0	2.9	5.6						
(% chg from previous forecast)		0.4	-	-4.1	-2.6	-		-0.6	-	-	
Rhodium	1 066	1 105	1 250	1 500	1 918	1 775	1 110	1 120	1 120	1 170	1 200
(y/y %)		3.7	13.1	20.0	27.9						
(% chg from previous forecast)		-0.0	-	-	-	-		-	-0.0	-0.0	
Silver	23.85	19	21.00	23.00	24.00	20.00	19.60	19.2	18.5	19.9	19.8
(y/y %)		-18.5	8.0	9.5	4.3						
(% chg from previous forecast)		-0.4	-	-	-	-		3.8	-7.0	0.5	
BASE METALS ($/mt)											
Aluminium ($/mt)	1 846	1 819	1 950	2 210	2 300	2 300	1 835	1 850	1 880	1 900	1 950
(y/y %)		-1.5	7.2	13.3	4.1						
(% chg from previous forecast)		0.6	-	-3.9	-	-		-	0.5	-	
Copper ($/mt)	7 327	7 000	7 450	7 700	8 000	6 400	6 780	6 930	7 250	7 330	7 600
(y/y %)		-4.5	6.5	3.4	3.9						
(% chg from previous forecast)		-2.1	-	-	-	-		-2.4	-	2.5	
Lead	2 138	2 211	2 480	2 750	2 850	2 850	2 120	2 250	2 370	2 450	2 500
(y/y %)		3.4	12.2	10.9	3.6						
(% chg from previous forecast)		-3.9	-6.4	-3.5	-	42.5		-5.5	-4.0	-2.0	
Nickel ($/mt)	15 012	17 526	18 000	19 200	18 500	16 000	18 500	18 700	18 250	18 000	18 500
(y/y %)		16.7	2.7	6.7	-3.6						
(% chg from previous forecast)		12.0	9.1	11.6	8.8	-		15.1	14.1	12.5	
Tin	22 624	24 672	30 000	32 000	28 000	24 000	23 165	25 400	27 500	28 000	29 000
(y/y %)		9.1	21.6	6.7	-12.5						
(% chg from previous forecast)		-1.3	-	-	-	-		-	-	-	
Zinc	1 908	2 109	2 230	2 500	2 700	1 850	2 070	2 130	2 210	2 180	2 270
(y/y %)		10.5	5.7	12.1	8.0						
(% chg from previous forecast)		6.4	8.8	-	-	-		9.2	7.8	9.0	
ENERGY											
WTI ($/bbl)	95	101	98	98	96	95	102.7	104	100	99	98
(y/y %)		7.0	-3.1	-							
(% chg from previous forecast)		3.8	-	-	-	-		7.2	1.0	1.0	
Brent ($/bbl)	110	108	107	105	103	95	109.5	109	107	106	107
(y/y %)		-1.3	-1.0	-1.9							
(% chg from previous forecast)		2.0	-	-	-	-		1.9	0.9	-0.9	
API2 ($/mt)	78	76	78	79	82	85	78.2	75	73	80	78
(y/y %)		-2.7	1.8	1.3							
(% chg from previous forecast)		-0.6	-	-	-	-		2.7	-8.8	2.6	
API4 ($/mt)	81	76	76	78	82	82	77.3	75	73	80	77
(y/y %)		-6.6	0.5	2.6							
(% chg from previous forecast)		-0.9	-	-	-	-		2.7	-8.8	3.9	
Newcastle ($/mt)	84	76	77	78.5	82	85	77.4	75	73	80	78
(y/y %)		-9.7	1.7	1.9	4.5						
(% chg from previous forecast)		-0.9	-	-	-	-		2.7	-8.8	2.6	
BULKS											
IO Fe 62% China CFR fines	135	108	105	98	93	88	104	104	102	110	96
(y/y %)		-20.4	-2.6	-6.7	-5.1						
(% chg from previous forecast)		-7.1	-	-1.0	-2.1	-		-8.0	-8.1	-4.3	
Austr hard coking coal fob	151	120	128	135	150	155	110	115	130	130	125
(y/y %)		-20.3	6.4	5.5	11.1						
(% chg from previous forecast)		-6.8	-7.9	-12.3	-7.4	-		-8.0	-7.1	-7.1	

Source: Standard Bank Research

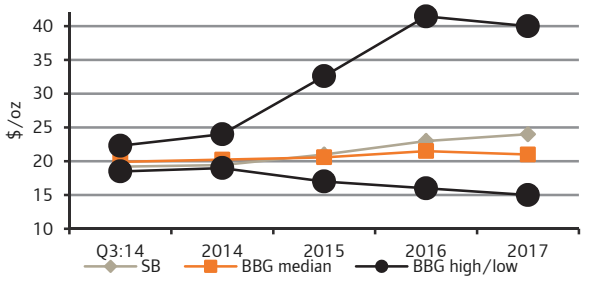
Standard Bank forecasts vs. consensus

Gold



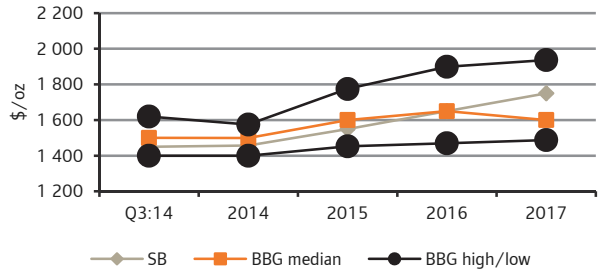
Source: Standard Bank Research, Bloomberg

Silver



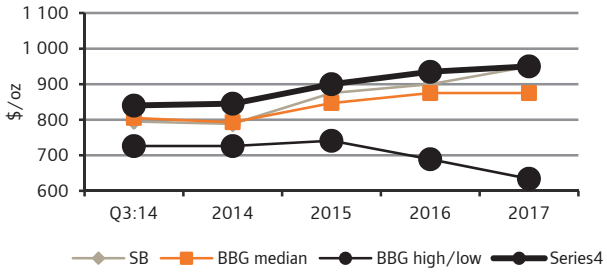
Source: Standard Bank Research, Bloomberg

Platinum



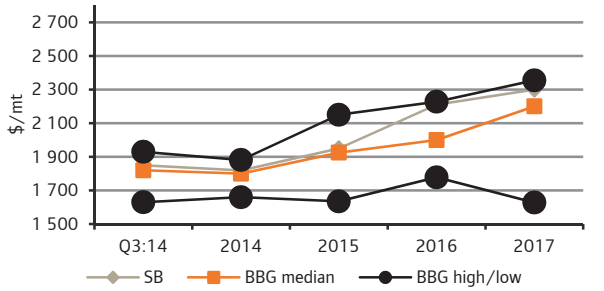
Source: Standard Bank Research, Bloomberg

Palladium



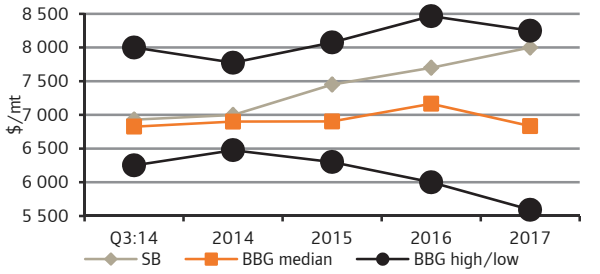
Source: Standard Bank Research, Bloomberg

Aluminium



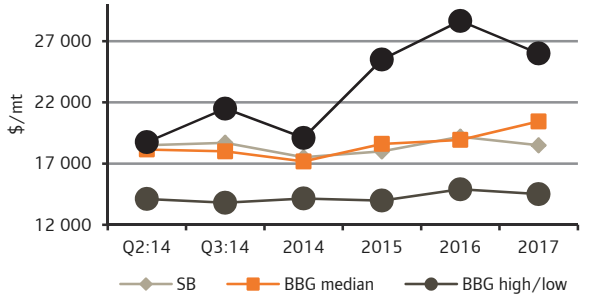
Source: Standard Bank Research, Bloomberg

Copper



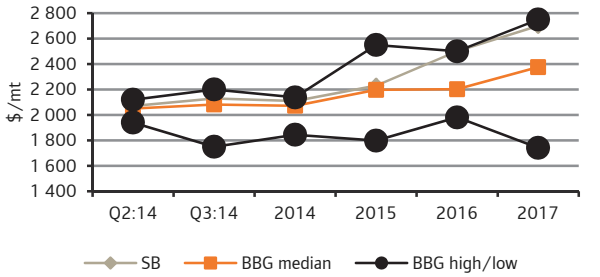
Source: Standard Bank Research, Bloomberg

Nickel



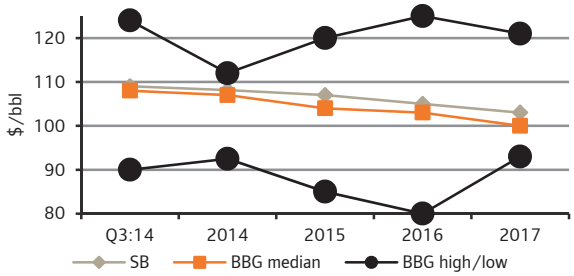
Source: Standard Bank Research, Bloomberg

Zinc



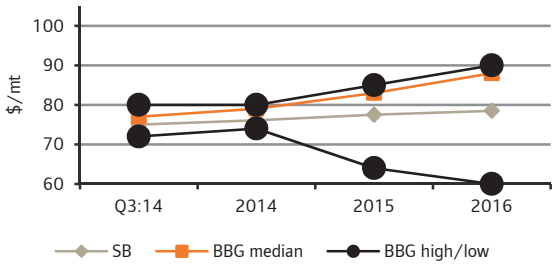
Source: Standard Bank Research, Bloomberg

Brent crude oil



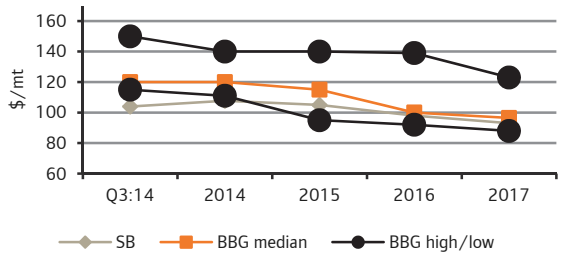
Source: Standard Bank Research, Bloomberg

Thermal coal – API2



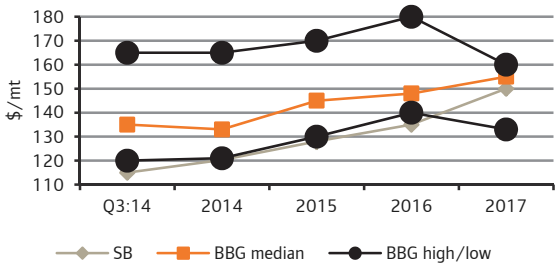
Source: Standard Bank Research, Bloomberg

Iron ore



Source: Standard Bank Research, Bloomberg

Australian hard coking coal



Source: Standard Bank Research, Bloomberg

Global growth forecasts

Real GDP (y/y)	2009	2010	2011	2012	2013	2014F	2015F	2016F
Global	-0.6	5.1	3.8	3.3	3.0	3.4	4.0	4.1
USA	-3.0	2.4	1.8	2.2	1.8	2.0	3.4	3.5
Eurozone	-4.4	2.0	1.5	-0.6	-0.5	0.5	0.7	0.7
United Kingdom	-3.9	1.8	0.9	0.2	1.4	2.0	2.2	2.3
Russian Federation	-7.9	4.3	4.3	4.0	4.1	4.2	4.2	4.2
Canada	-2.8	3.2	2.6	1.8	1.7	2.5	2.8	2.8
Brazil	-0.3	7.6	2.8	0.9	2.4	2.6	2.6	2.5
China	8.5	10.4	9.3	7.8	7.5	7.1	7.0	7.0
India	5.1	11.4	7.8	4.0	4.9	5.3	5.6	5.7

Source: Standard Bank Research, IMF

Gold

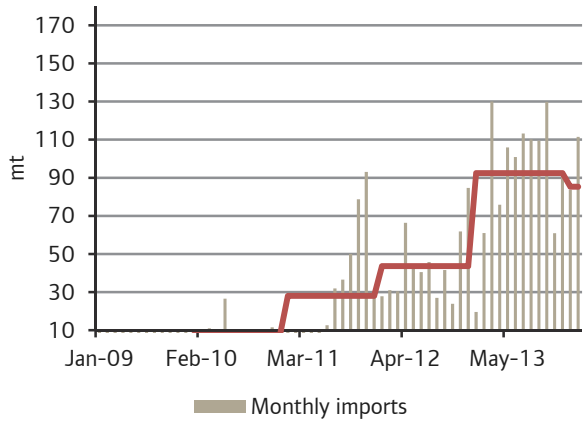
Asia demand still weak, with little change expected in Q3:14

We maintain that gold will struggle to gain significant upside in Q3. That said, Q4 may see stronger physical demand from Asia.

Asia demand this year has been poor

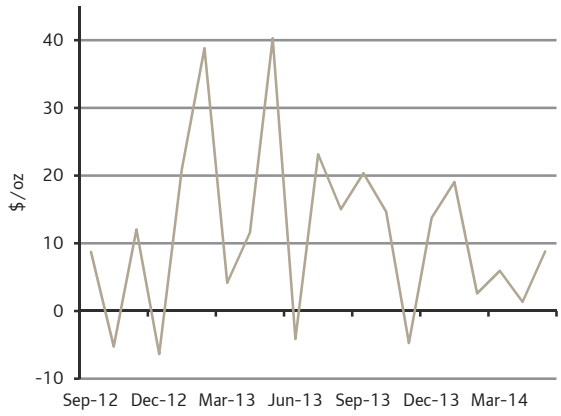
Asia demand this year has been poor. While China's imports via Hong Kong have been strong YTD (data available up to May), we expect the imports to slow in June, July and August. This is evident from the Shanghai gold exchange premium that has declined since April and remains largely around zero, indicating weaker demand. The behaviour of the SGE premium relative to the gold price leads us to believe that China demand has become much more sensitive to the gold price in recent months. With the SGE premium flat or even negative, the incentive to import gold into China has diminished.

Figure 1: China gold imports via Hong Kong



Source: Hong Kong Customs, Standard Bank Research

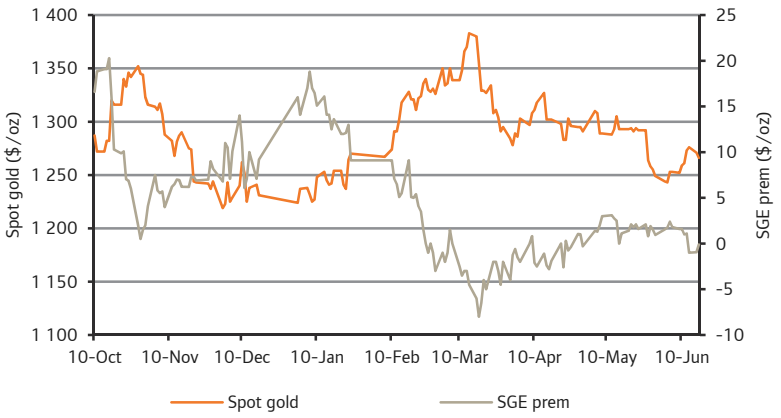
Figure 2: SGE premium



Source: SGE, Standard Bank Research

As can be seen in Figure 3, there is a negative relationship between the SGE premium and spot gold, with gold rallies resulting in lower demand for gold and a concomitant decline in the SGE premium. The gold price would have to move lower before China's gold imports will pick up to last year's levels.

Figure 3: Gold price vs. SGE premium



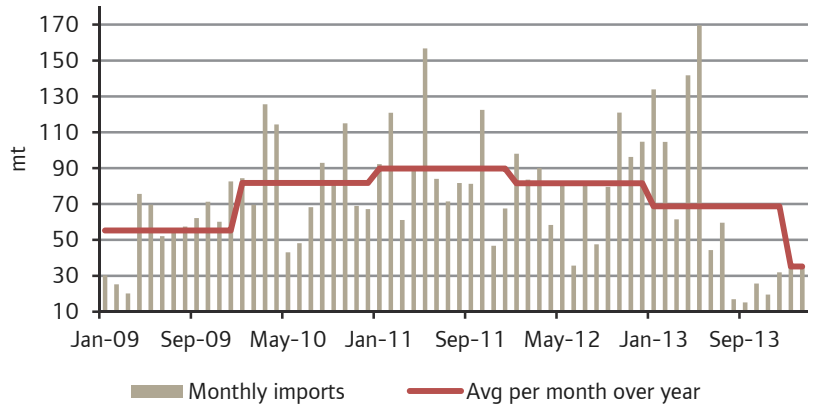
Source: SGE, Standard Bank Research

In contrast, Indian demand has been weak since June last year, mainly on the back of the import duties that were raised from 4% to 6% in January 2013, then from 6% to 8% in June 2013 and again from 8% to 10% in August 2013. The rise in the import duties has resulted in the monthly gold import figure for gold falling from a monthly

average of 81mt in 2012 to 68mt in 2013. Perhaps more startling is that between August last year and February this year (official), gold imports averaged only 24mt per month (see Figure 4).

Although there has not been any relaxation of import duties on gold yet, there is clearly upside for Indian imports of gold, should import duties be scaled back. This may well happen when India tables its Budget in July. But, if import duties are relaxed, official Indian gold imports could add an additional 30 -40mt demand per month. This would go a long way in offsetting the potential negative impact of further ETF liquidation.

Figure 4: India official gold imports



Source: RBI, Standard Bank Research

Historical correlations remain in place

Despite the large decline in ETF holdings since last year, the historical correlation between the gold price and other financial markets remains largely unchanged. We note that except for the period between 2004 and 2012 (when ETF holdings ramped up fast), gold always had a negative correlation with US equities, US real interest rates and also the trade-weighted dollar (see Figure 5).

Figure 5: Spot gold correlation with other financial assets

	1980 - 1989	1990 - 1997	1998 - 1999	2000 - 2003	2004 - 2007	2008	2009 - 2012	2013 YTD
ETFs	-	-	-	-	0.96	-0.73	0.94	0.95
S&P	-0.24	-0.35	-0.52	-0.65	0.92	0.77	0.87	-0.85
Real interest rate	-0.78	-0.16	0.14	-0.25	0.08	-0.56	-0.90	-0.68
Trade weighted $	-0.59	-0.47	-0.16	-0.80	-0.80	-0.90	-0.69	-0.68

Source: Standard Bank Research

If real rates go up, gold will go down

While gold liquidation via ETFs has slowed to a trickle YTD, we still see a risk to further liquidation.

During the first five months of 2014, gold ETF holdings were down 38.45mt, compared to a decline in holdings of 208mt during the last 5 months of 2013, and 869mt for the whole of 2013. It is clear that the decline in ETF holdings YTD pales in comparison with the liquidation seen last year. From a gold price perspective, that is bullish (relative to last year).

If government bond yields are lower YTD, why are gold ETF holdings not higher?

We believe that ETF liquidation has slowed since the start of the year partly because of US government bond yields that have actually declined since December (both in real terms and nominal terms, as reflected by the 10-year government bond yield and inflation-linked bond yields). However, there is a strong negative relationship between the 10-year US inflation-linked bond and ETF gold holdings and, by implication, the gold price (see Figure 6). If government bond yields are lower YTD, why are gold ETF holdings not higher? Ultimately, this is because we have turned the corner in interest

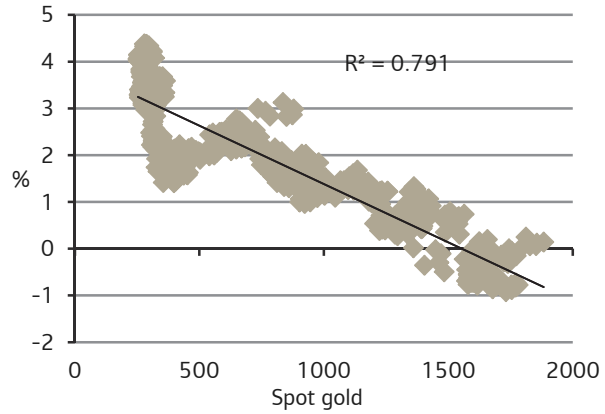
rates, and expectations are for the next move to be higher, not lower. It is a question of timing. If ETF holdings remained broadly flat this year, we would read this as a positive outcome for gold demand.

Bloomberg consensus puts the US 10-year nominal government bond yield at 3.2% in Q1:15. If inflation stays around 2%, it would imply a real rate of close to 1.2%. That would be much higher than the current 0.30% implied by the 10-year TIPS yield. The relationship in Figure 6 (although a somewhat naïve relationship) would imply a gold price closer to $1,100 in Q1:15.

Major source of demand remains lower than 2012, but better than 2013

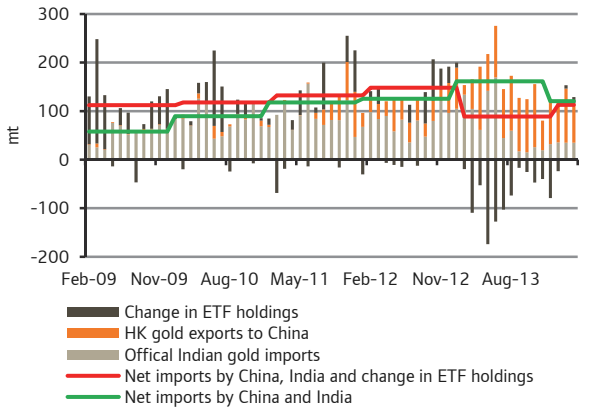
Because ETF holdings are being liquidated at a slower pace than last year, the combined demand from the major sources of gold demand (China, India and ETFs) is higher YTD than in 2013, but still much lower than in 2012 (Figure 7). But it is too soon to discount any further ETF liquidation.

Figure 6: US real interest rate (US 10y TIPS yield) vs. spot gold since 1997



Source: Standard Bank Research, Bloomberg

Figure 7: Demand from 3 large gold centres



Source: Standard Bank Research, RBI, HK Customs, Various ETFs

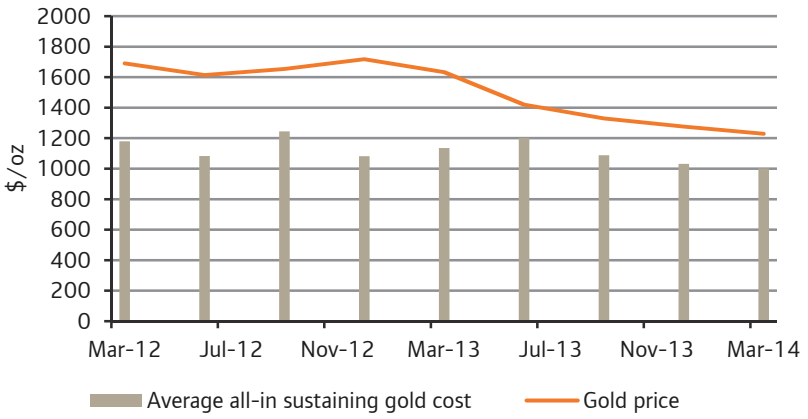
We believe that any price recovery will be relatively muted

Overall, we believe that bouts of weakness for gold will persist as US monetary policy normalises. This, in our view, will keep the gold price at bay for the next two quarters. Ultimately, ETF liquidation will stop and Indian demand will increase again. However, demand will be driven more by fabrication and jewellery demand, which is more price-sensitive, and less by ETF-type investment demand. As a result, we believe that any price recovery will be relatively muted.

On the supply side, we expect a marginal decline in mine production in coming years

On the supply side, we expect a marginal decline in mine production in coming years. With production costs being slashed by producers since the start of last year, the impact on existing production has been limited so far (see Figure 7). However, exploration and CAPEX have been cut back, which should see future mine supply dwindle. Although we believe that mine supply plays a lesser role in setting gold prices, at the margin a decline in primary supply relative to demand should add support to prices.

Figure 8: Average gold production cost vs. gold price



Source: WGC, Standard Bank Research

Supply/demand balance for gold

Key forecasts (tonnes)	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F	2017F
Mine supply	2 416	2 611	2 740	2 838	2864.1	3018.6	2 958	2 899	2 841	2 784
Old scrap supply	1 316	1 735	1 719	1 649	1591	1371	1 398	1 426	1 455	1 484
Primary supply	3 732	4 346	4 459	4 487	4455.1	4389.6	4 357	4 325	4 296	4 268
Jewellery	2 193	1 814	2 017	1 975	1951	2198	2 264	2 332	2 402	2 474
Industrial	439	410	466	453	407	405	417	430	443	456
Total fabrication	2 632	2 223	2 483	2 428	2 358	2 603	2 681	2 762	2 844	2 930
Bar hoarding/coins/medals	856	791	1184	1513	1289	1654	1 704	1 755	1 807	1 862
Exchange traded funds	321	617	368	162	279	-881	-31			
Primary demand	3 809	3 631	4 035	4 103	3 926	3 376	4 354	4 516	4 652	4 791
Primary surplus (deficit)	(77)	715	424	384	529	1014	3	(191)	(356)	(523)
Total official sector supply	296	34	(76)	(440)	-538	-364	(310)	(310)	(310)	(310)
Net hedging (de-hedging)	(352)	(234)	(108)	11	(40)	(50)	10	10	10	10
Net surplus (deficit) residue	(133)	514	240	(45)	(49)	600	(297)	(491)	(656)	(823)
Prices ($/oz)	872	973	1225	1572	1669	1411	1 298	1 380	1 460	1 550

Source: GFMS, WGC, SBG Securities, Standard Bank Research

Silver

We still see silver trading below $20/oz in 2014

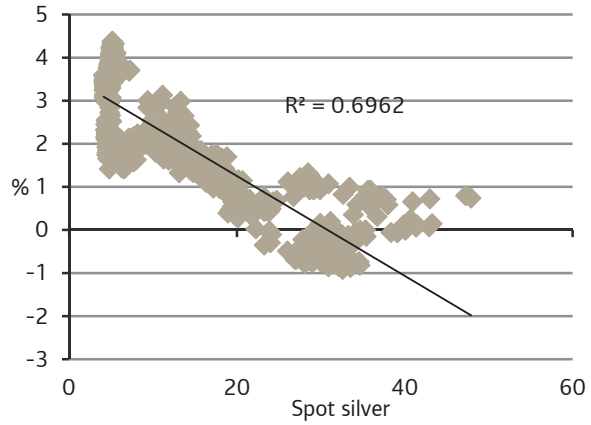
Unlike gold, silver has a much larger industrial demand base, with industrial demand constituting just over 40% of total silver demand. As a result, manufacturing and industrial production should play an important role in the price evolution of this metal.

However, investment demand remains important and a key driver, especially in an environment where there is excess metal inventory. Should US real interest rates rise, it would be negative for the silver price – as in the case of gold. The negative correlation between the silver price and US real interest rates is quite strong (see Figure 1), although less than gold due to silver's higher industrial demand component.
As mentioned in the gold section, general market expectations remain for higher US real rates over the next 12 months and, as a result, we expect these expectations to remain a drag on the gold price.

ETF holdings in silver have remained sticky

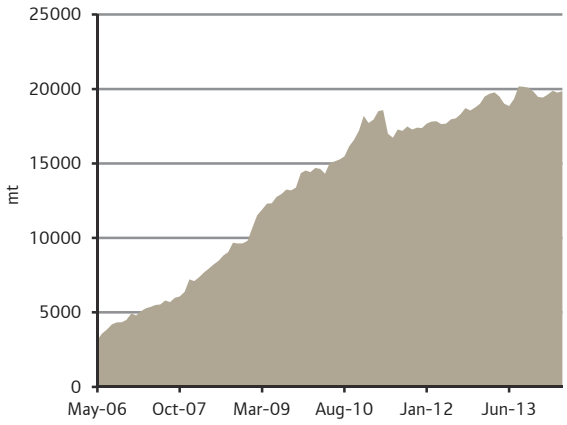
Overall, ETF holdings in silver have remained sticky, although the pace at which holdings have increased has slowed substantially in recent months (see Figure 2).
We maintain that in conjunction with higher US real interest rates, these holdings are a potential risk to the silver price.

Figure 1: Silver price vs. US 10y real interest rate



Source: Standard Bank Research

Figure 2: Silver ETF holdings

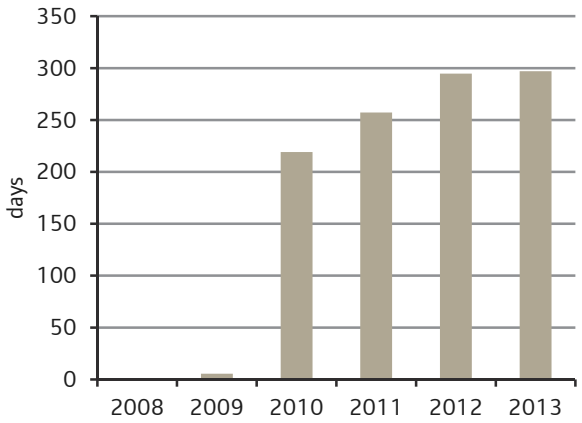


Source: Various ETFs

As with other precious metals, China remains an important player and also a net importer of the metal. Regarding China's imports, two points are worth noting:

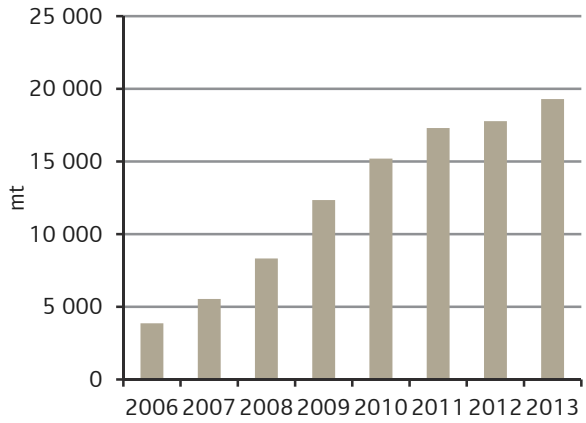
Firstly, given the exceptional rate of imports between 2010 and 2012, we believe that China has substantial volumes of silver within the domestic market. In fact, our latest estimates point to silver inventory of around 300 days of domestic consumption, or just over 4000mt of silver (see Figure 3 and Figure 4).

Figure 3: China silver stock build - days consumption



Source: Standard Bank Research

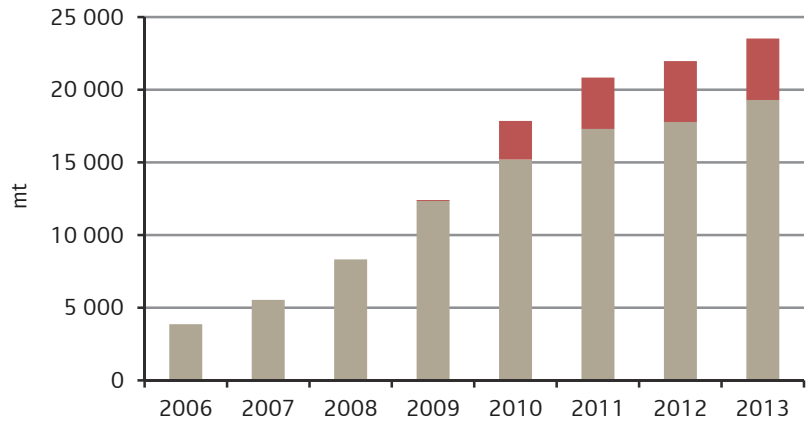
Figure 4: China silver stock build - mt



Source: Standard Bank Research

The positive news is that inventory in China has seemingly stabilised. But, compared to ETF holdings, China's inventory is still small (Figure 5).

Figure 5: China silver stock vs. ETF holdings



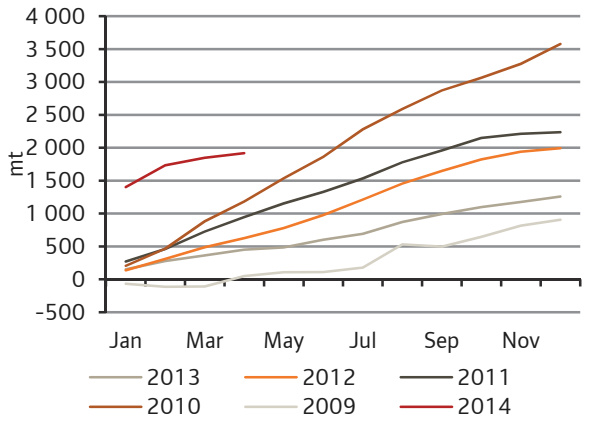
Source: Various ETFs, Standard Bank Research

The pace of imports has slowed and we do not expect a substantial increase in imports before at least year-end

Secondly, after a good start to silver imports in 2014, the pace of imports has slowed and we do not expect a substantial increase in imports before at least year-end (see Figure 6). This slowdown is driven by weaker investment and industrial demand growth, as well as the inventory in China.

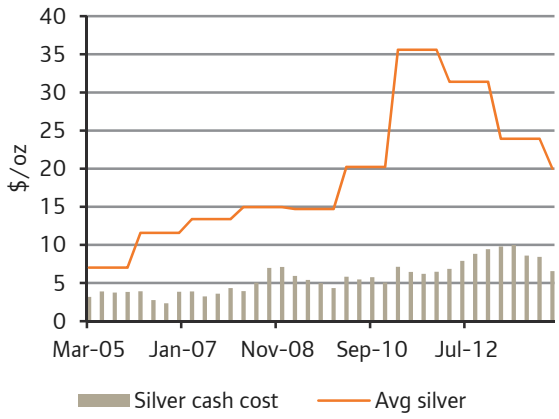
Because production cost for silver production in general is very low compared to the current silver price, we do not expect any slowdown in silver production (see Figure 7). Furthermore, with an improvement in the zinc price in the coming year, silver as a by-product may well also rise as zinc production starts to ramp up once again in 2016 and beyond.

Figure 6: China silver imports YTD



Source: China Customs, Standard Bank Research

Figure 7: Silver average cash cost vs. spot price



Source: Bloomberg Industries, Standard Bank Research

Industrial production is likely to increase this year and 2016 and, for the first time since 2010, we expect demand to outpace supply. If ETF holdings remain sticky, the silver price may well start to edge lower as we head into the second half of the decade.

We maintain that silver's risk is to the downside in the short term and that rallies will fade

From a tactical perspective, we maintain that silver's risk is to the downside in the short term and that rallies will fade. Although the fundamentals, from a supply/demand perspective, is slowly improving, we believe the risk of ETF liquidation combined with China's inventory overhang warrant caution before establishing a long-term strategic position in silver. Tactically, downside could extend as far as $15/oz – a level where we see value. We believe that a normalisation of US interest rates may be the trigger for such a flush-out. Once the US interest rate cycle has normalised (over the next 18 – 24 months), we believe that the long-term strategic case for silver would have improved substantially.

Supply/demand balance for silver

Key forecasts (tonnes)	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Supply	27 510	28 493	30 483	31 674	32 228	33 141	34 004	34 751	35 538
Mine production	21 263	22 272	23 370	23 689	24 281	25 131	26 011	26 791	27 595
Scrap recovery	6 248	6 221	7 113	7 985	7 947	8 010	7 993	7 960	7 943
Demand	27 225	24 325	27 684	27 265	27 447	28 193	29 164	30 223	31 376
Industrial	15 323	12 601	15 552	15 132	15 739	16 382	17 154	18 021	18 950
Photography	3 150	2 465	2 241	2 056	1 871	1 702	1 575	1 472	1 384
Jewellery, silverware & coins	8 751	9 259	9 891	10 078	9 838	10 109	10 436	10 730	11 042
Surplus/Deficit	286	4 168	2 799	4 409	4 781	4 948	4 840	4 528	4 162
Prices ($/oz)	15.0	14.7	20.2	35.3	31.2	23.5	20.0	21.0	23.0

Source: Silver Institute; Standard Bank Research

Platinum Group Metals

The medium-term outlook seems neutral to weak despite just over 950Kozs of platinum lost, 530Kozs of palladium, and 125Kozs of rhodium production during the strikes in South Africa. Once a ramp-up of production has been completed (another 2 – 3 months), production losses could be even more.

We don't expect any sustainable price collapse in platinum

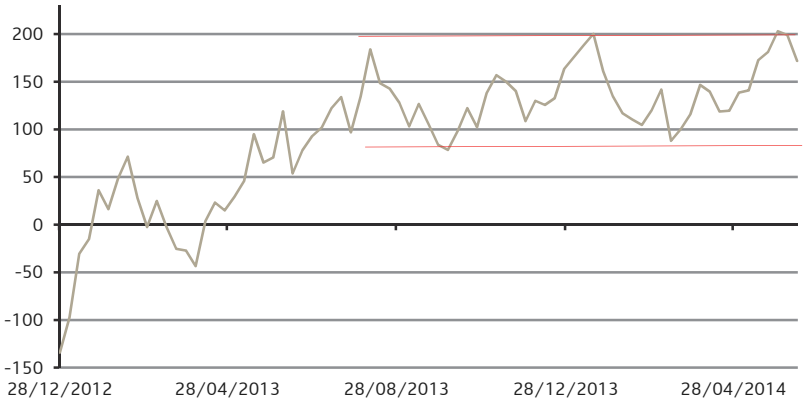
A frequently asked question is: where is the post-strike price for platinum if the price during the strike failed to rally? Bottom line, we don't expect any sustainable price collapse in platinum. In answer to the same question about palladium, the metal's outlook is a bit more blurred, given lingering uncertainty about Russian supply and the continued ramp-up in the South African palladium ETFs.

Our analysis of above-ground platinum and palladium inventory published in June last year indicates that this inventory is indeed high (see our report *PGM – much more metal than we thought* dated 26 June 2013). While some of this inventory would have reduced due to the large deficits anticipated this year, levels remain high. As a result, on balance, the bias may lie towards having to wait longer before PGM prices move higher on a sustainable basis.

For platinum, our tactical view since mid-last year has been that there is value in the metal below $1,400 and that rallies above $1,500 are likely to fade. This view has largely been based on (1) the swing factor in platinum demand (i.e. jewellery that we believed would improve if platinum prices fell too far below $1,400 but equally weaken if platinum prices rose too fast and far above $1,500) and (2) our estimation of metal availability, which would likely keep prices subdued for longer. We continue to hold this view because overall, although the market has tightened up relative to before the strike, fundamentals have not changed enough, in our view, to push prices substantially higher just yet.

In the short- to medium term, we would judge the platinum price relative to two factors from a value perspective (once the market has settled and long positions that entered the market following the strike have normalised). The first factor is the spread relative to gold, which we would expect to remain largely between $100 and $200 in the short- to medium term. The second factor is developments in the Chinese jewellery market – the most volatile component of total demand in our view. Any signs of weakness or strength may, however, alter our view. Jewellery demand after all makes up 30% of total platinum demand.

Figure 1: Platinum/gold spread



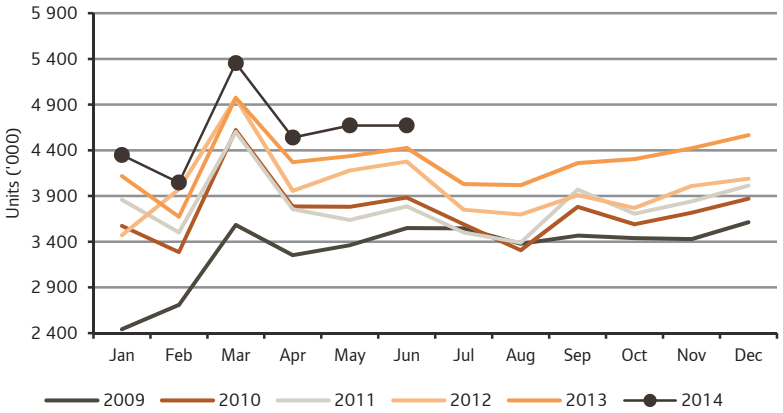
Source: Standard Bank Research

As far as palladium is concerned, we believe that some speculative length will exit the market. However, palladium to us is a metal that should be approached from the long side as opposed to the short side. Apart from the fact that this is a market in large deficit, short-term dynamics (such as the ramp-up in the SA ETFs, and what we believe should be a rise in China's palladium imports into the second half of 2014) should see the price remain well supported for now. From a tactical perspective, as mentioned, we would not be surprised if the metal gives back some of its recent gains once speculative length exits the market. We would start looking for value below $800.

We would start looking for value with palladium below $800

Auto sales data for the four large auto markets – US, EU, Japan and China – points to vehicle sales continuing to hit all-time highs (see Figure 2), driven by China and the US. For the year to May, auto sales are up 7.4%, compared to the same period last year. We expect total auto production to grow by just less than 5.5% this year (and 6.8% in 2016). Given that H2 sees a seasonal slowdown (see Figure 2), we believe that YTD vehicle sales remain on track for production to hit target.

Figure 2: Auto sales - US, EU, Japan and China



Source: Standard Bank Research

The latest data from China indicates that platinum imports into the country declined, falling from 205Kozs in April to 165Kozs in May. Platinum imports year-to-date are weak (Figure 3) in comparison with platinum imports into China for the first 5 months of previous years. Platinum imports into China appear to be falling behind not only the run-rate seen in 2013 but also those seen in 2012, 2011 and 2010. Currently, it appears that China's platinum imports will lag 2013 levels. While a sharp pickup in demand and imports in the latter part of 2014 is possible, the difference between now

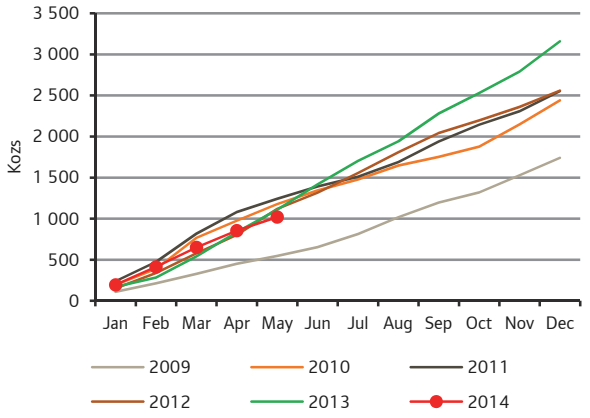
and 2013 is that in June last year the platinum price collapsed, spurring demand from China during H2:13.

Although precious metal imports cannot be directly compared under all circumstances, we have also observed a slowdown of imports of gold (via Hong Kong) and silver into China since March.

We ascribe the weakness in platinum imports in especially May to two factors

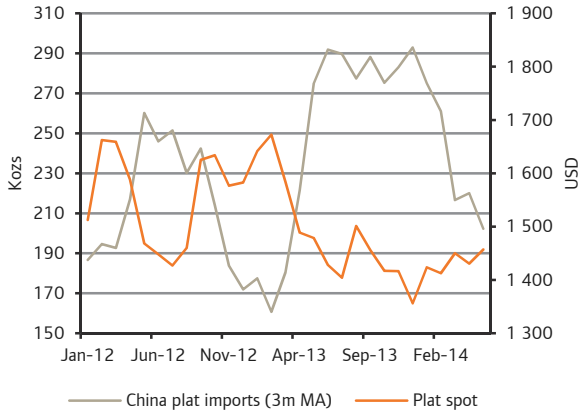
We ascribe the weakness in platinum imports in especially May to two factors: (1) a general lack of demand due to little price volatility compared to e.g. last year and (2) the platinum price relative to the gold price. The platinum/gold spread has increased from an average of $132 in April to an average of $170 in May (the widest average monthly spread since February). Apart from the fact that platinum imports have become much more sensitive to the platinum price (Figure 4), we also believe that from a jewellery demand perspective China has become more sensitive to the gold price relative to the platinum price since 2012.

Figure 3: China platinum imports YTD



Source: Standard Bank Research, China Customs

Figure 4: China platinum imports vs. spot platinum price



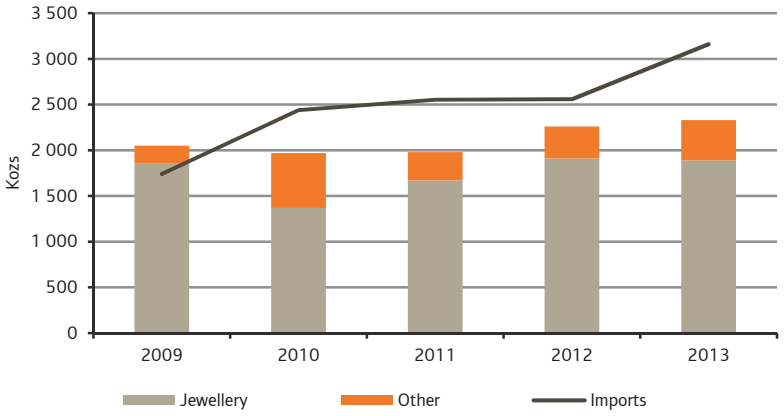
Source: Standard Bank Research, China Customs

The more important question is: how do platinum imports into China stack up against total demand and specifically jewellery demand for the country?

Platinum import data is only available since 2009, so making valuable empirical conclusions from this limited data is difficult. However, what stands out when comparing platinum imports with total platinum demand in China is that 2013 was an outlier for imports relative to consumption levels of the metal during the same period (Figure 5). This does not necessarily imply that jewellery demand in China will be lower, but it does make a stronger case that imports into China may well decline y/y.

Generally, the country does not export much metal (i.e. metal that enters China stays in China), and therefore a decline in imports would be price-negative (all else being equal).

Figure 5: China platinum demand vs. platinum imports



Source: Standard Bank Research, China Customs

At the moment, we forecast a rise of 42Kozs in platinum jewellery demand from China this year – up from 1,841Kozs in 2013 to 1,883Kozs in 2014. Should platinum imports fall further behind import levels seen in 2013, this rise in jewellery demand may prove too bullish. However, we are reluctant to make an adjustment to jewellery demand just yet, given that the relationship between imports and jewellery demand is not necessarily linear.

If jewellery demand is weak, the platinum price is unlikely to rally

Given that we forecast a deficit in the platinum market of over a 1mozs this year due to strikes, the potential, small decline may have little effect on prices. However, we believe that jewellery demand is the swing demand factor in a market that is still well supplied by metal. If jewellery demand is weak, the platinum price is unlikely to rally.

Supply/demand balance for platinum

Key forecasts (thousands of oz)	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
South Africa	4 515	4 635	4 635	4 855	4 095	4 159	3 252	4 407	4 684
Russia	805	785	825	835	800	790	790	790	790
North America	325	260	200	350	295	292	289	285	282
Zimbabwe	180	226	280	340	340	406	464	467	465
Other	116	119	110	100	110	110	110	110	110
Total producer supply	5 940	6 025	6 050	6 480	5 640	5 757	4 904	6 060	6 331
Recycled supply	1 130	830	1 085	1 225	1 130	1 236	996	1 166	1 266
Total supply	7 070	6 855	7 135	7 705	6 770	6 993	5 900	7 226	7 597
Gross autocatalyst	3 655	2 185	3 075	3 105	3 240	3 382	3 597	3 875	4 166
Autocatalyst recovery	(1 130)	(830)	(1 085)	(1 225)	(1 130)	(1 236)	(996)	(1 166)	(1 266)
Net autocatalyst	2 525	1 355	1 990	1 880	2 110	2 146	2 601	2 709	2 900
Jewellery (net)	1 365	2 245	1 685	1 670	1 890	1 989	2 035	2 101	2 121
Chemical	400	290	440	470	450	459	468	478	487
Electrical	230	180	220	220	155	155	155	155	155
Fuel cells	0	0	0	0	0	0	0	0	0
Glass	315	10	385	555	180	180	180	180	180
Investment	555	660	655	460	455	731	15	0	0
Petroleum	240	210	170	210	200	204	208	212	216
Medical and biomedical	245	250	230	230	235	243	250	259	268
Other	290	190	300	355	340	345	349	354	359
Total demand	6 165	5 390	6 075	6 050	6 015	6 451	6 262	6 448	6 686
Surplus (deficit)	(225)	635	(25)	430	(375)	(694)	(1 357)	(388)	(355)
Price ($/oz)	1 611	1 208	1 612	1 722	1 553	1 487	1 470	1 550	1 650

Source: SBG Securities Estimates, Standard Bank Research, JM

Supply/demand balance for palladium

Key forecasts (thousands of oz)	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
South Africa	2 430	2 370	2 640	2 560	2 330	2 141	1 800	2 421	2 543
Russia	3 660	3 635	3 720	3 480	2 880	2 700	2 600	2 600	2 600
North America	910	755	590	900	905	913	930	957	964
Zimbabwe	140	180	220	265	265	327	358	362	362
Other	170	160	185	155	165	167	168	170	172
Total producer supply	7 310	7 100	7 355	7 360	6 545	6 248	5 856	6 510	6 641
Recycled supply	1 140	965	1 310	1 655	1 660	1 895	2 439	2 743	2 892
Total supply	8 450	8 065	8 665	9 015	8 205	8 143	8 296	9 253	9 533
Gross autocatalyst	4 465	4 050	5 580	6 155	6 615	7 137	7 754	8 504	9 228
Autocatalyst recovery	(1 140)	(965)	(1 310)	(1 695)	(1 660)	(1 895)	(2 439)	(2 743)	(2 892)
Net autocatalyst	3 325	3 085	4 270	4 460	4 955	5 241	5 315	5 761	6 336
Chemical	350	325	370	440	530	541	551	562	574
Dental	625	635	595	540	530	520	510	500	490
Electronics (net)	1 025	975	970	895	770	778	785	793	801
Jewellery (net)	855	705	495	295	255	242	230	219	208
Investment (net)	420	625	1 095	-565	470	-96	7	0	0
Other	75	70	90	110	105	106	107	108	109
Total demand	6 675	6 420	7 885	6 175	7 615	7 331	7 505	7 943	8 518
Surplus (deficit)	635	680	(530)	1 185	(1 070)	(1 083)	(1 649)	(1 433)	(1 877)
Price ($/oz)	351	266	529	733	644	720	785	875	900

Source: SBG Securities, Standard Bank Research, JM

Supply/demand balance for rhodium

Key forecasts (thousands of oz)	2008	2009	2010	2011	2012E	2013	2014F	2015F	2016F
South Africa	574	663	632	641	576	585	460	620	659
Russia	85	70	70	72	90	89	89	89	89
North America	18	15	10	20	23	23	22	22	22
Zimbabwe	15	19	19	29	30	36	41	41	41
Other	3	3	3	3	3	3	3	3	3
Total producer supply	695	770	734	765	722	736	615	775	814
Recycled supply	227	187	241	277	259	182	179	201	230
Total supply	922	957	975	1 042	981	917	794	976	1044
Gross autocatalyst	768	619	727	715	782	840	911	998	1 081
Autocatalyst recovery	(227)	(187)	(241)	(277)	(259)	(182)	(179)	(201)	(230)
Net autocatalyst	541	432	486	438	523	658	733	798	851
Chemical	68	54	67	72	81	83	84	86	88
Electrical	3	3	4	6	6	6	6	6	6
Glass	38	19	68	77	31	31	31	31	31
Other	25	21	21	38	66	30	34	38	43
Total demand	675	529	646	631	707	807	888	959	1018
Surplus (deficit)	20	241	88	134	15	(72)	(273)	(184)	(204)
Price ($/oz)	6 529	1 597	2 452	2 018	1 274	1 066	1 120	1 250	1 500

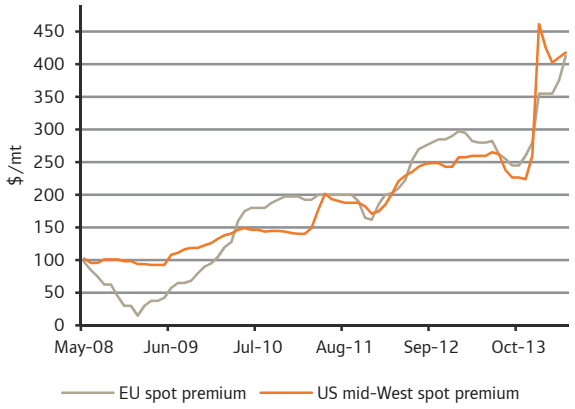
Source: SBG Securities, Standard Bank Research, JM

Aluminium

Aluminium continues to be dominated by the interplay between premia and price, with both strengthening as we head towards the end of Q2. In addition, volatility seems to be returning, both to the all-in price and now, after a period of eerie and unrealistic calm, to the LME forward structure.

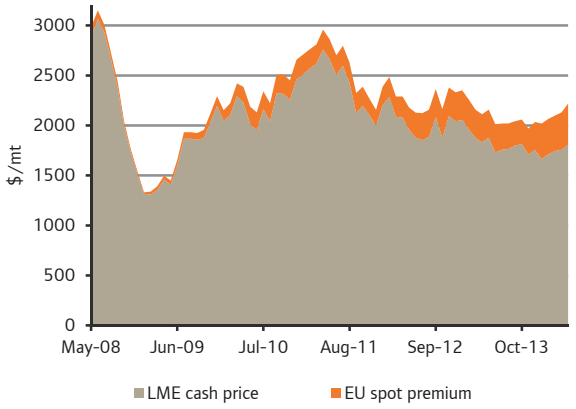
As it stands, the LME aluminium all-in price is made up of three components; the LME Cash Price (in cheapest to deliver warehouse location), the queue premium (the premium related to the time spent in warehouse), and the "real demand" premium. The queue premium is relatively static, with the volatility being seen in the cash price and real demand components of the all-in price. Tightening markets in the western world, coupled with the impact of ex-LME/off-warrant financing deals on metal availability, has led to scrambles for material, pushing premia up to record levels (see Figure 1).

Figure 1: LME regional spot premiums



Source: Metals Bulletin

Figure 2: All-in aluminium price



Source: Metals Bulletin, LME, Standard Bank Research

Tightness is again in evidence over the past quarter after a period of very, very low volatility in the nearby spreads

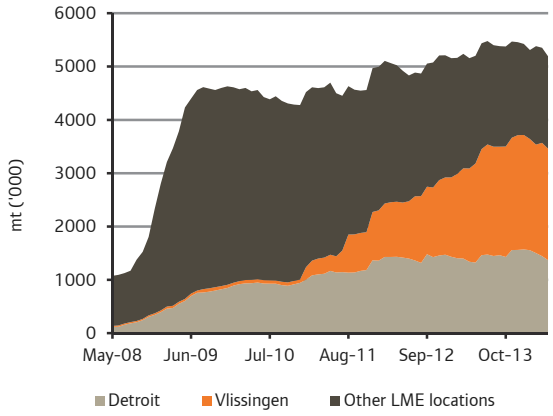
As far as LME prices go, both CTA-type and more traditional speculative activity is having an effect from time to time, though perhaps more interestingly it is more of an issue if participants look to play aluminium from the short side. Looking at the level of LME aluminium inventory to market open interest, the short position associated with the hedges for this material is elevated at just over 17% of market open interest. The high level of exchange inventory and the short futures hedges associated with that stock mean that aluminium is pre-disposed to tightening up should speculative length drop away. This tightness is again in evidence over the past quarter after a period of very, very low volatility in the nearby spreads.

After such a long period of relatively low volatility, it seems that the nearby spreads are also becoming more sensitive to positioning than they have been. It's not entirely clear why, though it's perhaps worth noting that a significant change over the past year or so is the structure of the aluminium industry (the financing part at least), in particular banks exiting from LME storage and warehouse ownership. While bank warehouse ownership has been maligned by many in the industry, what it did appear to allow was the relatively smooth matching up physical financing activity, and the passive length from commodity indices. If that process is now perhaps not quite as smooth and efficient as it has been previously, and episodes of borrowing activity don't tie up quite so seamlessly with the index rolls, spread tightness and increased volatility in the forwards looks like becoming the norm again.

Inefficiencies with the LME queue system persist. We note that while there are other aluminium inventories outside the LME system these inventories tend to be quite stable,

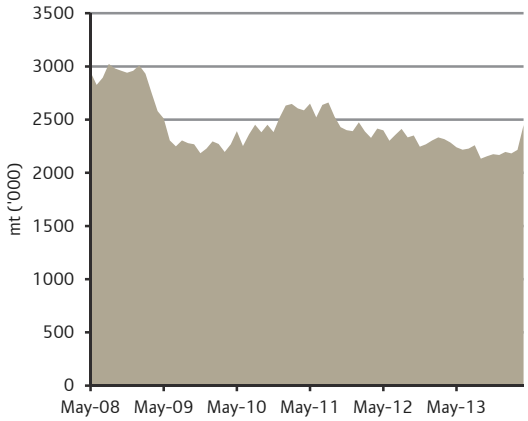
given that much of this good inventory tends to allocated for working inventory (see Figure 3). As a result, LME warehouse inventories tend to be the port to call in the event of spot metal needs.

Figure 3: LME aluminium inventory



Source: LME, Standard Bank Research

Figure 4: Other aluminium inventories (excluding LME)

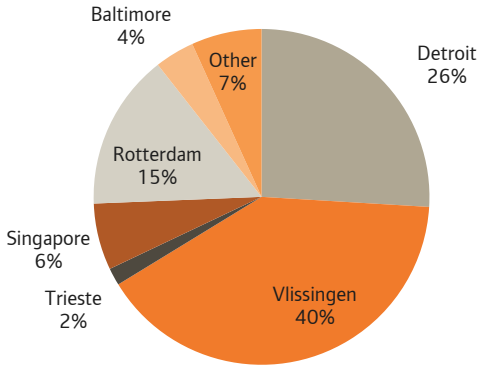


Source: IAI

Detroit and Vlissingen holds 66% of total LME inventory. Vlissingen inventory remains stubbornly high, though Detroit stocks are falling. Nevertheless, Detroit still has 1.176 Mt of metal sat in the exit queue. With an average outflow of 3,000 mt/day, that's still some 392 working days. In the case of Vlissingen, this queue is close to 540days.

We expect the aluminium market to enter deficits in the next 3 years. As a result, inventory will be drawn down and the market will increasingly rely on LME inventory to satisfy demand. However, 93% of aluminium inventory is currently being held in only six locations (see Figure 5).This concentration could potentially delay metal availability. Our current deficit forecasts for the aluminium market is a deficit of 217Kt or 600mt per day in 2014 and a deficit of 624Kt in 2015 or just below 2,000mt per day. While current LME rules are likely to satisfy demand based on our deficit estimates, premia are likely to remain elevated and even rise once we enter proper deficits, especially in Europe and the US.

Figure 5: LME aluminium inventory by location



Source: LME, Standard Bank Research

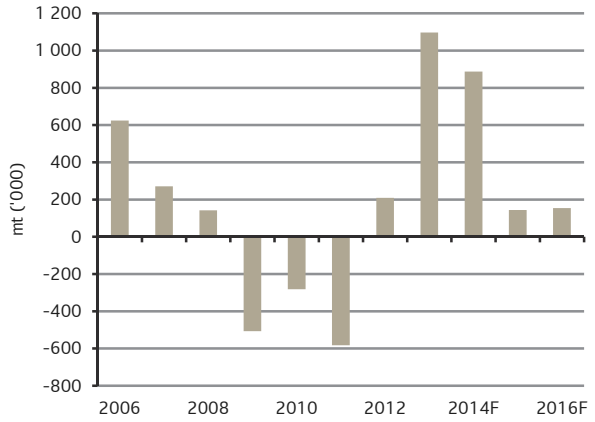
While the LME queue system may resolve itself slowly, there will also be time for the CME and LME premium hedging options to take hold. The LME is looking at introducing its Aluminium Premium Contract in Q1-2015. The initial impression of the contract is

that it would in effect be an on-exchange warrant swap, though the LME now envisages it trading in the ring, on LME Select and on the telephone.

As mentioned, with aluminium set for deficit markets over the next few years, the ingredients are there to finally eat into the stock overhang. Supply restarts are always a risk, however, particularly should the all in price continue to edge higher. In that regard, should either the CME or LME provide a viable premium hedging facility, it will be interesting to see how producers use it.

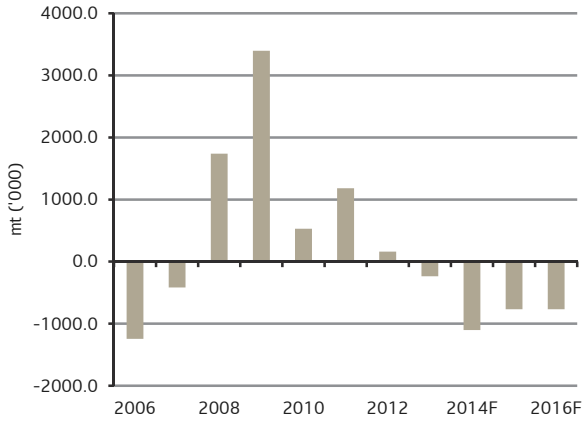
We should mention China, the world's largest producer and consumer of aluminium. Worth highlighting in particular is the fact that China's aluminium market remains dislocated and isolated from the rest of the world after years of surpluses (see Figure 6), while the rest of the world has been in a deficit since last year (see Figure 7). SHFE prices remain deeply depressed with an inefficient and effectively theoretical SHFE-LME arbitrage instead being expressed vicariously through semi products.

Figure 6: China aluminium market balance



Source: MBR, IAI, Standard Bank Research

Figure 7: World (ex-China) aluminium market balance



Source: MBR, IAI, Standard Bank Research

On the demand side, the transport sector remains key (see Figure 8) where the continued efforts to lightweight vehicles, with the Ford F150 pickup a notable headline grabber in recent months. While auto demand will undoubtedly increase levels of aluminium usage, there are some limitations. In particular there is competition from high strength steels, and reluctance by some high volume car manufacturers, particularly in Asia to make the switch. Nevertheless, we forecast solid global aluminium demand growth of 6.1% this year and 6.0% in 2015.

Figure 8: Aluminium sector demand per region (%)

	EU	US	Japan	China
Construction	23	10	14	14
Transport	41	40	41	41
Electronic equipment			12	12
Consumer durables		7		
Machinery	14	8		
Packaging	15	24	11	11
Power/Energy		9		
Other	7	2	22	22

Source: Standard Bank Research

With aluminium therefore juggling solid demand with reduced supply, higher premia, queues, financing activity, Chinese semi products, smelter costs and restarts, premia hedging mechanisms and a more volatile forward structure, the market might actually move on from the LME vs. US consumers and Russian producer storyline that has dominated the past few quarters. Finally, the prospect of higher interest rates may also start to have a bearing on financing activity as we head into 2015.

Aluminium supply/demand balances

Thousands of tonnes	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Production											
Africa	1 864	1 815	1 715	1 681	1 742	1 808	1 639	1 810	1 836	1 869	1 869
North America	5 332	5 642	5 778	4 758	4 691	4 971	4 851	4 918	4 527	4 703	4 745
Latin America	2 492	2 558	2 660	2 508	2 305	2 184	2 052	1 904	1 722	1 779	1 781
Asia (ex. China)	2 108	2 207	2 301	2 636	2 691	2 876	3 034	2 789	3 478	4 113	4 421
Western Europe	4 182	4 305	4 618	3 723	3 800	4 027	3 605	3 535	3 478	3 584	3 585
Eastern/Central Europe	4 665	4 935	5 141	4 400	4 532	4 744	4 719	4 559	3 996	4 061	4 361
Australasia	2 274	2 315	2 297	2 211	2 277	2 306	2 186	2 105	1 947	1 910	1 910
China	9 349	12 607	13 076	13 444	16 132	18 047	21 200	24 292	26 169	27 449	29 370
Middle East	1 633	1 741	1 907	2 200	2 796	3 374	3 738	3 957	4 624	5 034	5 410
Total	33 899	38 126	39 492	37 561	40 965	44 337	47 024	49 870	51 776	54 501	57 451
Year-on-year % change	6.4%	12.5%	3.6%	(4.9%)	9.1%	8.2%	6.1%	6.1%	3.8%	5.3%	5.4%
Consumption											
North America	7 653	7 276	5 913	4 422	4 819	4 700	5 363	5 582	5 815	6 089	6 266
Latin America	1 367	1 474	1 623	1 536	1 597	1 784	1 762	1 884	1 976	2 128	2 296
Asia (ex. China)	7 096	7 158	7 286	7 208	8 376	8 892	9 104	9 162	9 604	10 136	10 679
Western Europe	6 952	7 186	6 856	4 844	6 423	6 597	6 246	6 135	6 201	6 262	6 305
China	8 725	12 336	12 934	13 951	16 414	18 630	20 991	23 195	25 282	27 305	29 216
Others	2 726	2 842	2 998	2 711	3 090	3 133	3 187	3 053	3 115	3 204	3 301
Total	34 519	38 272	37 611	34 672	40 718	43 737	46 653	49 010	51 993	55 125	58 064
Year-on-year % change	7.8%	10.9%	(1.7%)	(7.8%)	17.4%	7.4%	6.7%	5.1%	6.1%	6.0%	5.3%
Implied surplus (deficit)	(620)	(146)	1 881	2 889	247	600	371	860	(217)	(624)	(613)
Stocks analysis											
IAI	1 621	1 553	1 676	1 205	1 396	1 404	1 255	1 169			
LME	698	929	1 338	4 624	4 275	4 979	5 210	5 458			
COMEX	122	40	35	0	0	0	0	0			
SHFE	19	89	207	293	441	208	442	182			
Total	3 033	2 887	4 768	7 657	7 904	8 504	8 875	9 735	9 518	8 894	8 281
Stocks as weeks of consumption	5.6	5.7	6.6	11.5	10.1	10.1	9.9	10.3	9.5	8.4	7.4

Source: Metals Bulletin, Standard Bank Research

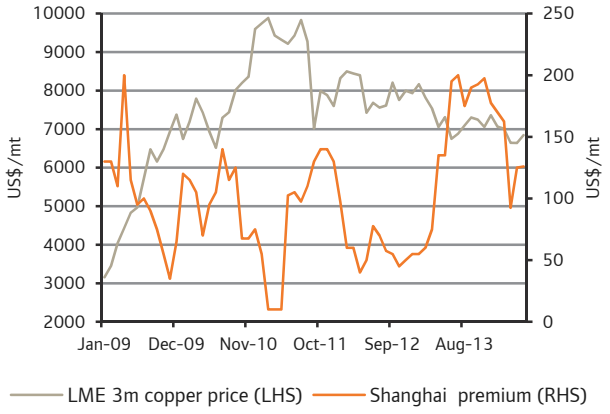
Copper

We remain positive towards copper

Copper has had a volatile but broadly positive Q2, with the fruits of China's mini stimulus now giving the metal an extra boost as we head into the slower summer period. Our optimism towards copper, voiced in the previous quarterly report, seems to have been justified, in spite of the spate of domestic Chinese bond defaults occurring at the time. This quarter's mishap, namely the widely reported issues at the Chinese port of Qingdao, is also likely to have little long-term impact in our view. We remain positive towards copper, with critically low levels of exchange inventory and solid demand likely to keep copper prices well supported and sees both nearby and farther-dated spreads tighten up as we head into H2-14.

Moving into Q3, we note that the SHFE-LME arbitrage is opening sporadically, bonded premia are recovering strongly after the Qingdao episode, demand remains strong while supply is merely ok, rather than shooting the lights out (see Figure 1). Disruption to concentrate supply from Indonesia has certainly helped matters, while issues with ore grades and deleterious elements also suggest the path from concentrate to refined metal isn't quite as smooth as it should perhaps look on paper (see Figure 2). We are forecasting a modest surplus this year of 107 kt, though we do not believe it will be a barrier to higher prices, with the magnitude of the surplus being dwarfed by even quarterly changes in Chinese bonded inventory.

Figure 1: Shanghai spot premium



Source: MB, Standard Bank Research

Figure 2: Mine production vs. refined production

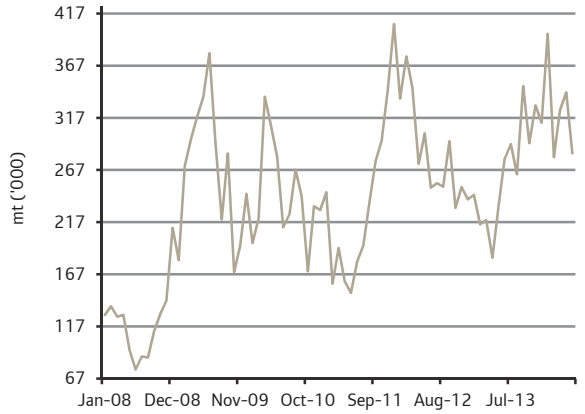
Source: MBR, Standard Bank Research

The latest ICSG data suggests that world copper usage increased by 14% y/y in Q1, though this was likely driven by an increase in Chinese bonded warehouse inventory which saw Chinese apparent demand climb by 29%. On the supply side, mine output climbed by 4% y/y in Q1-14, hindered by the on-going issues in Indonesia that have impacted on both Grasberg and Batu Hijau. Refined output meanwhile climbed 5% y/y in Q1. Even accounting for the ICSG measure of bonded stock changes, the study group suggests that the copper market was in an 80 kt deficit, while their raw balance, stripping out seasonal adjustments and bonded inventory changes, puts copper in a 206 kt deficit in Q1-14.

Chinese imports of copper ores and concentrates remain very strong, averaging just under 890 kt/month so far this year, compared to 840 kt/month in 2013. What isn't clear, however, is what average ore grades have done over this period. Increased levels of elements such as arsenic, and lower grades may well have resulted in a reduction in average grades. This of course has implications as to how much material is being handled and in turn stockpiled back in order to help with blending. Refined imports remain strong (Figure 3), though they have ebbed and flowed with fluctuations in the SHFE-LME arbitrage. Refined exports are reasonably steady, and though they are also

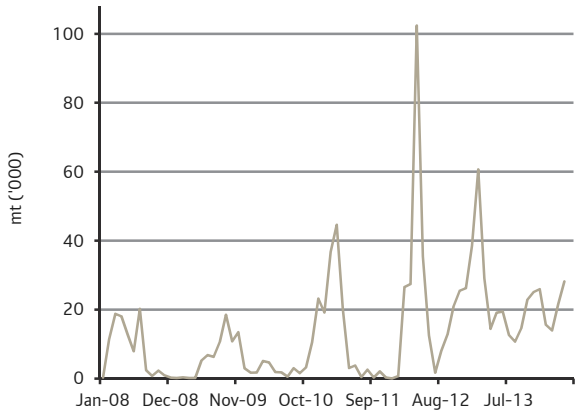
reacting to the arbitrage, show little sign of the flood of material expected from China by some participants (Figure 4).

Figure 3: China refined copper imports



Source: China Customs

Figure 4: China refined copper exports

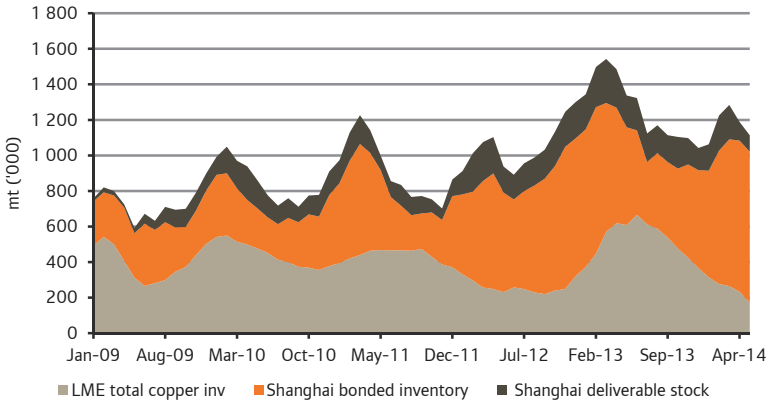


Source: China Customs

The past few years have seen a steady relocation of copper inventory from LME locations to China, the main source of global copper demand. The inventory resides in bonded warehouses, mainly around the city of Shanghai, being financed in warehouse until it is ultimately taken into mainland China to be consumed by copper fabricators.

Global inventory, including estimates of Chinese bonded stocks, are around 1.1Mt, around 600 kt lower than the peak seen in early 2013 (see Figure 5). Most of the decline has come from Exchange warehouses servicing the LME, SHFE and Comex. Bonded inventories have generally increased, reflecting the relocation of LME inventory and the preferential delivery of copper units to the world's largest consumer of the red stuff. The rise in bonded inventory is also due to an increase in commodity financing deals involving copper specifically. Currently, there is some 800 kt or so of copper sat in bonded warehouses in Shanghai, while LME inventory is at the lowest level since 2008 when the global financial crisis and credit crunch started to see material being dumped into LME warehouses.

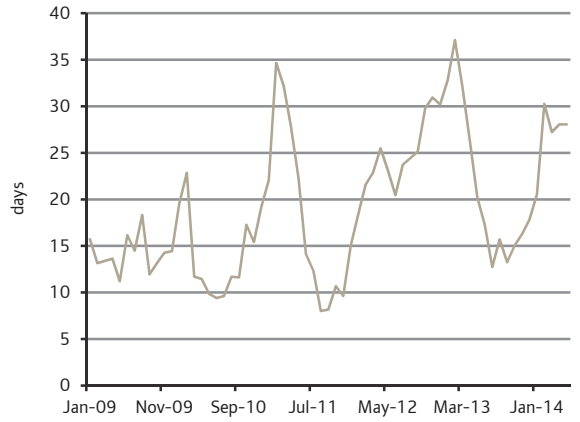
Figure 5: Copper inventory



Source: LME, SFE, Bloomberg Industries, Standard Bank Research

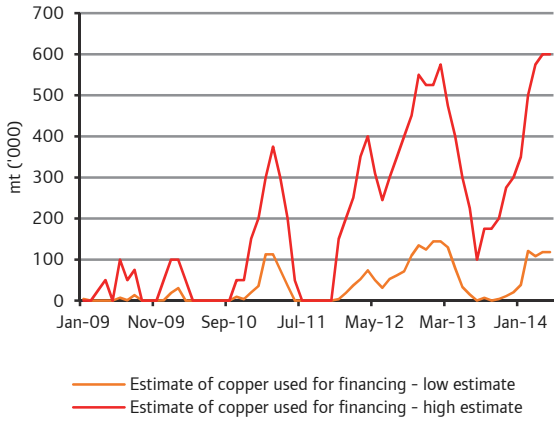
We believe it is important to mention that in terms of China refined consumption, the bonded inventory is currently at 28 days' worth Chinese refined copper consumption. This remains broadly in line with levels seen over the past five years (Figure 6). Of the 800Kt of copper in bond in Shanghai, we estimate that between 400kt and 600kt metal is tied up in financing deals (Figure 7).

Figure 6: Shanghai bonded stock in days consumption



Source: Standard Bank Research

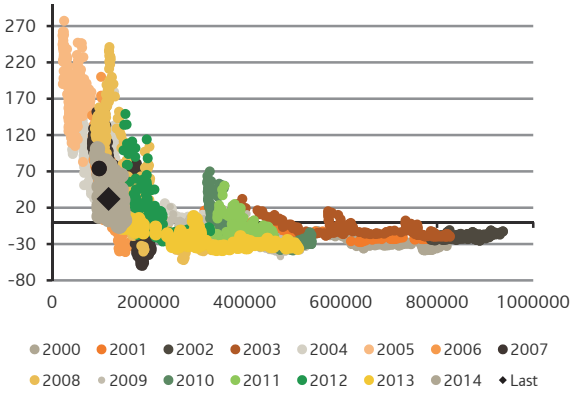
Figure 7: Estimate of copper used for financing in China



Source: Standard Bank Research

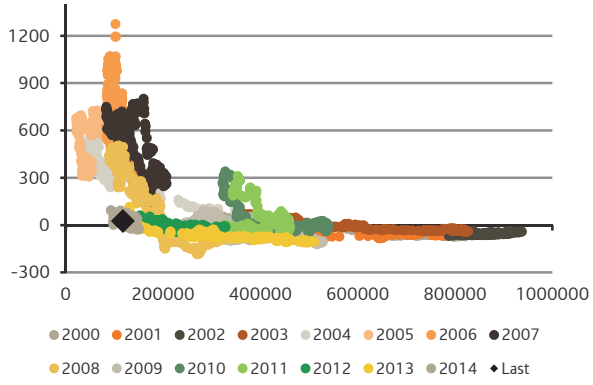
Copper spreads eased significantly amid recent concerns over Chinese demand, and the fallout from the Qingdao story. With the dust settling, and little sign of a panicked rush to the exit from financiers, LME Cash-3m spreads are in-line with historical levels, albeit lying more toward the benign end of the spectrum (Figure 8). Looking further forward, however, and the 3-15 month spread is incredibly benign given on-warrant LME stock levels and is behaving as if inventory (on-warrant at least) should be some 300 kt higher then they currently are (Figure 9). A more normal range for the backwardation, given current on-warrant stock levels would be anywhere from $250-$1050.

Figure 8: LME Cash-3m spread vs. copper on-warrant stock



Source: LME, Standard Bank Research

Figure 9: LME 3m - 15m copper spreads vs. on-warrant stock



Source: LME, Standard Bank Research

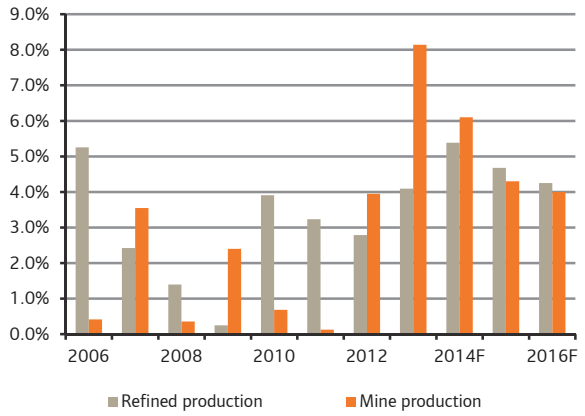
The normal transmission mechanism for drawing down bonded inventory is either a re-opening in the SHFE-LME arbitrage (which has already occurred in recent weeks) or a sustained and significant backwardation to attract stocks into LME sheds.

Fear, in the wake of the Qingdao story, looks likely to have been the main reason for the copper spreads to ease, though the market was already rather complacent. With the copper spreads remaining anomalously benign, there seems little hope that metal will suddenly flow out of China into the LME, suggesting that the risk is that spreads will tighten, which in turn should provide further support to prices.

Turning to copper's balance sheet, we expect mine prodcution to conitnue to grow at a decent pace of 6.1% this year and 4.3% next year before declining to 4% in 2016. Mine production growth is expected to outpace refined prodcution growth yet again this year which is likely to ensure that the concetnrate market remains well supplied (Figure 10).

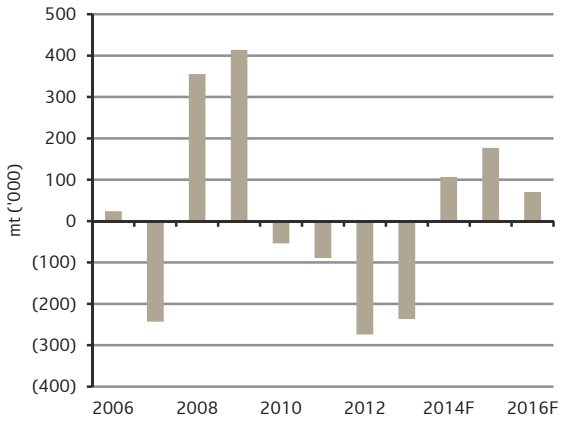
Demand growth is expected to come in at 3.7% this year before picking up to 4.4% in 2015. We have made little adjustments in our overall demand numbers, resulting in small surplusses for copper in the next 3 years of 107kt in 2014, declining to an almost balance market, with a surplus of only of 70kt in 2016 (Figure 11).

Figure 10: Mine production vs. refined production growth



Source: MBR, Standard Bank Research, ICSG, WBMS

Figure11: Refined copper market balance



Source: MBR, Standard Bank Research, ICSG, WBMS

Copper supply/demand balances

Thousands of tonnes	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Mine production											
Total	14 984	15 516	15 571	15 945	16 054	16 074	16 709	18 069	19 171	19 996	20 795
Year-on-year % change	0.4%	3.6%	0.4%	2.4%	0.7%	0.1%	4.0%	8.1%	6.1%	4.3%	4.0%
Refined production											
Africa	563	592	601	705	870	960	1 057	1 304	1 395	1 479	1 597
North America	2 155	2 157	2 013	1 753	1 664	1 705	1 649	1 704	1 772	1 845	1 882
Latin America	3 553	3 586	3 771	3 948	3 877	3 700	3 416	3 405	3 439	3 439	3 467
Asia (ex. China)	4 180	4 122	3 906	3 889	3 943	3 778	3 851	3 492	3 576	3 647	3 757
China	3 047	3 499	3 795	4 051	4 540	5 163	5 879	6 839	7 660	8 426	9 074
Australasia	429	442	502	446	424	477	460	476	484	488	488
Europe	3 605	3 559	3 620	3 461	3 648	3 796	3 813	3 729	3 751	3 785	3 827
Total	17 532	17 957	18 208	18 253	18 966	19 579	20 125	20 949	22 077	23 109	24 092
Year-on-year % change	5.3%	2.4%	1.4%	0.2%	3.9%	3.2%	2.8%	4.1%	5.4%	4.7%	4.3%
Refined consumption											
North America	2 863	2 647	2 512	2 063	2 176	2 218	2 233	2 328	2 375	2 413	2 437
Latin America	554	536	576	521	656	599	624	631	650	682	723
Asia (ex. China)	4 680	4 493	4 233	3 954	4 243	4 115	4 096	3 907	3 977	4 057	4 219
China	3 820	4 957	5 202	7 119	7 385	7 881	8 896	9 830	10 420	11 149	11 900
Europe	5 208	5 143	4 917	3 833	4 226	4 497	4 193	4 219	4 270	4 346	4 452
Others	383	424	412	349	334	358	357	271	279	285	290
Total	17 508	18 200	17 852	17 839	19 020	19 668	20 399	21 186	21 970	22 932	24 022
Year-on-year % change	4.5%	4.0%	(1.9%)	(0.1%)	6.6%	3.4%	3.7%	3.9%	3.7%	4.4%	4.8%
Implied surplus (deficit)	24	(243)	356	414	(54)	(89)	(274)	(237)	107	177	70
Stocks analysis											
LME	191	199	341	502	378	372	321	366			
COMEX	31	14	31	90	59	80	64	15			
SHFE	31	26	15	95	132	93	205	126			
Chile	359	224	195	184	184	204	279	353			
Other producer	283	298	285	301	296	295	334	284			
Merchant	18	21	26	22	21	21	22	17			
Consumer	149	125	142	96	72	88	75	80			
Total	1 062	907	1 035	1 290	1 142	1 153	1 300	1 241	1 347	1 524	1 595
Stocks as weeks of consumption	3.2	2.6	3.0	3.8	3.1	3.0	3.3	3.0	3.2	3.5	3.5
LME cash prices											
Historical & base case ($/tonne)	$6 730	$7 126	$6 969	$5 150	$7 539	$8 810	$7 965	$7 327	$7 000	$7 450	$7 700

Source: Standard Bank Research, MBR

Lead

Lead finally looks like it's coming to life as we head into Q3

Lead finally looks like it's coming to life as we head into Q3, after enduring a rather tough Q2. For a metal with fairly decent underlying fundamentals lead struggled badly, while what started out as mild indifference turned into downright neglect as open interest fell to multiyear lows as participants looked elsewhere for volatility and a more compelling fundamental story.

LME Select turnover in lead averaged around 3,950 lots/day since April, compared to 4,740 lots/day over 2013. By way of comparison, nickel turnover on LME Select has averaged 4,972 lots/day on a ytd basis and 5,338 lots/day from the beginning of April. This relegates lead to 5th position in terms of daily activity which has further served to keep the metal isolated and ignored by the speculative community. That said, however, lead looks like it is finally coming to life, breaking out of a downward trend in prices and challenging its late-April highs.

The latest ILZSG data is supportive for lead suggesting that the market was in a 12 kt deficit over the first four months of this year. That deficit includes a10.3% fall in Chinese apparent consumption as the country goes through a de-stocking episode. We expect lead to record a modest 18 kt deficit this year, and to remain in deficit for both 2015 and 2016. During that period, stocks measured as weeks of consumption are also likely to fall to very low levels, amongst the lowest in the LME complex, which should help lend support to prices.

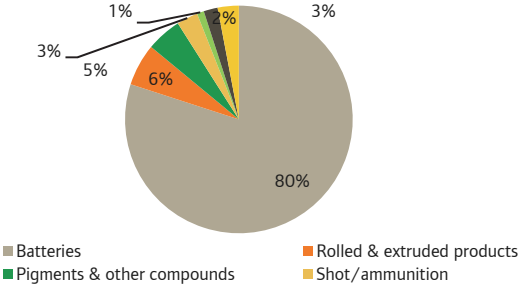
Chinese destocking activity has certainly lessened the general feeling of tightness in the market, though LME headline inventory has still fallen by 10% over the course of the year so far to 193 kt, while SHFE stocks have also fallen by nearly 25% to 67 kt. While Chinese apparent consumption has taken a hit, imports of lead ores and concentrates have remained strong, with imports for the first five months of the year averaging 126 kt/mth, up some 16% y/y.

In spite of the current deficit environment and expectations of refined tightness, lead has recently been overhauled by zinc, with the heavy metal trading at a discount to its cousin for the first time since mid-2012. Ordinarily, with lead possessing the better underlying fundamentals, both in terms of expected deficit/surplus this year and stock levels, lead prices should quickly overhaul zinc once again. With lead prices essentially range-bound for the best part of a year, however, and with liquidity and market participation dying away until very recently, it has been zinc that has captured the market's attention, with the expected tightening of the zinc market as we head into the middle of the decade, plus some bullish comments from zinc producers helping galvanize the galvanising metal.

If lead remains unloved, however, prices will continue to languish in the shadows

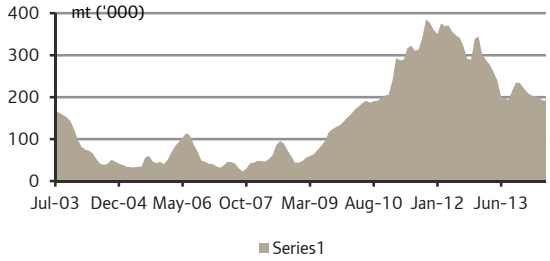
We will see if lead's resurgence in late June can last. If it can, and if lead can attract some liquidity and interest away from the other LME metals, then lead looks like recovering quickly and reasserting its position over zinc. If lead remains unloved, however, prices will continue to languish in the shadows.

Figure 1: Global demand for lead by sector



Source: ILZSG

Figure 2: LME lead inventory



Source: LME

Supply/demand balances for lead

Thousands of tonnes	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Mine production											
Total	3 525	3 626	3 818	3 810	4 161	4 636	5 007	5 386	5 569	5 803	5 942
Year-on-year % change	2.6%	2.9%	5.3%	(0.2%)	9.2%	11.4%	8.0%	7.6%	3.4%	4.2%	2.4%
Refined production											
Africa	120	121	116	98	116	120	98	91	95	99	100
North America	1 806	1 802	1 791	1 701	1 785	1 777	1 744	1 743	1 665	1 678	1 683
Latin America	266	275	330	274	252	282	302	311	339	349	356
Asia (ex. China)	1 206	1 326	1 372	1 306	1 463	1 661	1 704	1 737	1 789	1 807	1 867
China	2 715	2 757	3 452	3 773	4 158	4 604	4 591	5 100	5 508	5 949	6 365
Australasia	253	252	270	259	229	246	203	232	241	251	256
Europe	1 661	1 779	1 815	1 645	1 731	1 767	1 779	1 795	1 831	1 822	1 813
Total	8 027	8 312	9 146	9 056	9 734	10 457	10 421	11 009	11 467	11 955	12 439
Year-on-year % change	5.4%	3.6%	10.0%	(1.0%)	7.5%	7.4%	(0.3%)	5.6%	4.2%	4.2%	4.1%
Refined consumption											
North America	1 923	1 777	1 695	1 490	1 642	1 686	1 657	1 747	1 766	1 757	1 740
Latin America	236	221	296	360	365	384	407	422	438	455	482
Asia (ex. China)	1 566	1 650	1 732	1 689	1 793	1 934	2 041	2 053	2 076	2 138	2 202
China	2 213	2 943	3 456	3 925	4 171	4 588	4 574	5 077	5 382	5 812	6 219
Europe	1 968	1 944	1 813	1 503	1 642	1 631	1 622	1 664	1 691	1 691	1 686
Others	145	138	130	116	125	119	119	138	134	139	141
Total	8 051	8 673	9 122	9 083	9 738	10 342	10 420	11 101	11 486	11 992	12 470
Year-on-year % change	3.6%	7.7%	5.2%	(0.4%)	7.2%	6.2%	0.8%	6.5%	3.5%	4.4%	4.0%
Implied surplus (deficit)	(5)	(361)	24	(27)	(4)	115	1	(92)	(18)	(37)	(31)
Stocks analysis											
LME	41	45	45	147	209	353	318	214			
Producer	137	140	147	137	127	129	137	179			
Consumer and merchant	130	120	114	106	111	92	110	114			
SHFE	0	0	0	0	0	31	75	90			
Total	308	305	306	390	447	605	640	597	579	542	511
Stocks as weeks of consumption	2.0	1.8	1.7	2.2	2.4	3.0	3.2	2.8	2.6	2.4	2.1
LME cash prices											
Historical & base case ($/tonne)	$1 288	$2 595	$2 090	$1 661	$2 182	$2 398	$2 077	$2 138	$2 211	$2 480	$2 750

Source: Standard Bank Research, MBR

Nickel

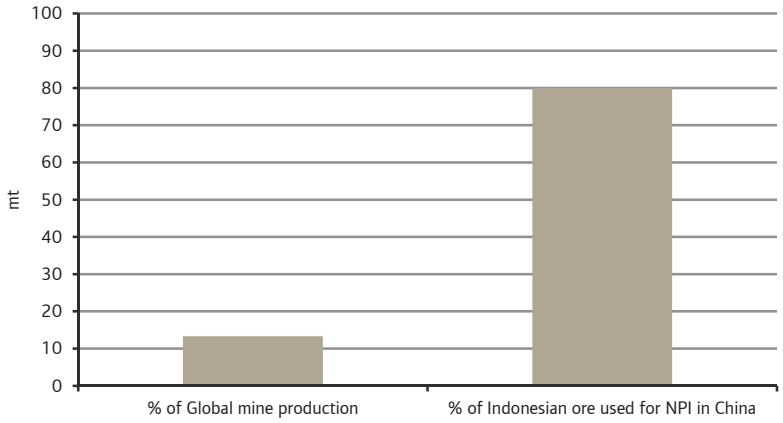
Nickel has been the main story in the base metals so far this year

Nickel has been the main story in the base metals so far this year, with the Indonesian ore ban helping spark a rally that peaked in early May at $21,625, some 62% higher than the lows seen in early January.

As noted in our previous quarterly report, LME nickel turnover remains very strong, even relegating lead into fifth place as far as Select volumes are concerned. Open interest has started to come down from its record levels seen in April and early May, suggesting that, along with weaker prices of late, that profit taking and long liquidation has kicked in. Nevertheless, even now, prices are still some 37% higher than those January lows, with the ore export ban and the knock on effects in terms of nickel pig iron (NPI) production and costs continuing to help lend support to refined prices.

Chinese import data attests to the lack of Indonesian ore. Indonesia's nickel mine production constitutes around 14% of global nickel mine production. However, Indonesian ore constitute 80% of total ore used for China's NPI production (Figure 1).

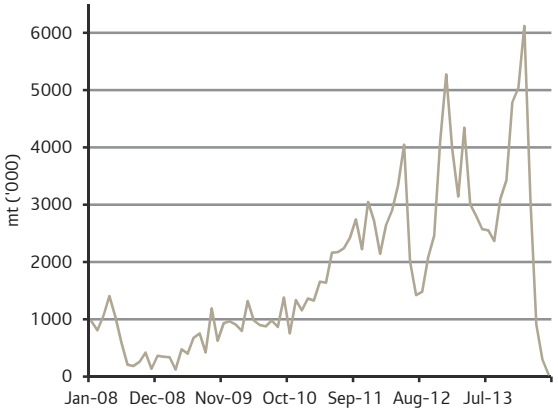
Figure 1: Indonesian nickel ore production and China use of Indonesian ore



Source: Standard Bank Research

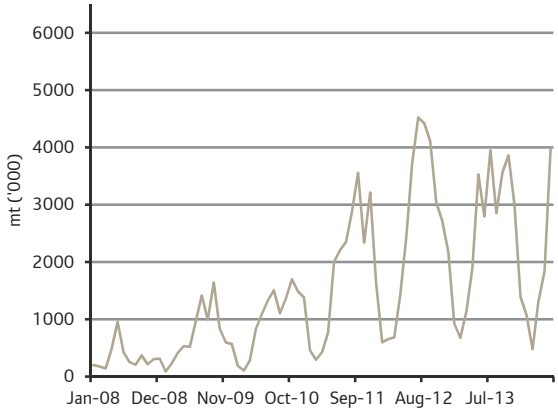
Total imports dipped sharply in February, falling from 7.269 Mt to 3.578 Mt. Imports continued to decline in March and April, falling to 2.225 Mt before finally picking up above the 4Mt mark again in May. Indonesian ore exports to China in May were only 38.9 kt. interestingly, imports from the Philippines have surged, coming in at 3.983Mt in May, compared to a low of 476 kt in February (see Figure 2 and Figure 3).

Figure 2: China nickel ore imports from Indonesia



Source: China Customs

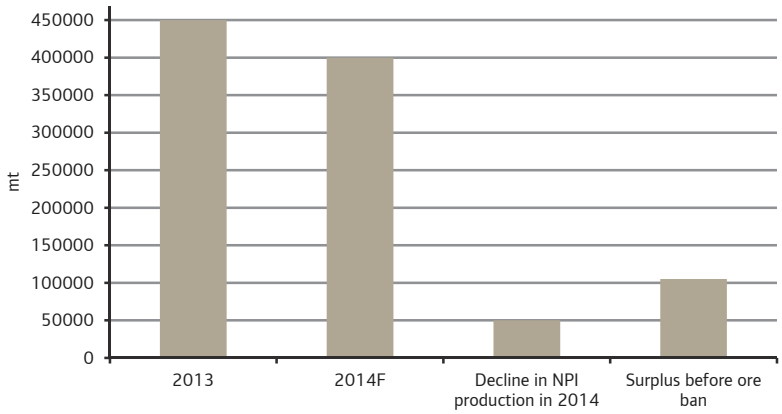
Figure 3: China nickel ore imports from Philippines



Source: China Customs

That said, however, the most that the Philippines has ever managed to export to China in one month was 4.523 Mt back in July 2012. With average monthly Chinese nickel ore imports in 2012 and 2013 coming in at 5.417 Mt and 5.932 Mt respectively, there remains a looming gap in terms of both quantity and ore-type. The tightening up of the NPI sector, plus increased costs should continue to lend support to nickel prices, and help precipitate the onset of market deficits from next year. In total, we expect NPI production in 2014 to decline by between 50 kt and 70 kt, which should see the surplus for the nickel market we forecast at the moment cut substantially to around 21 kt this year.

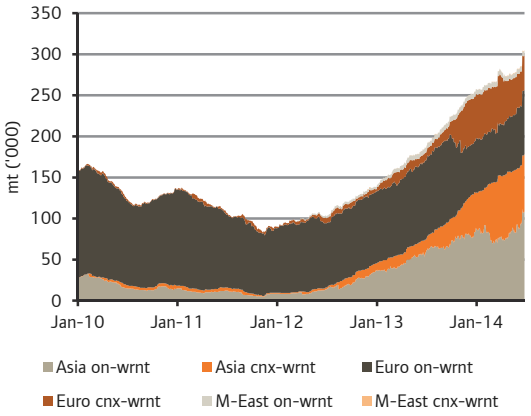
Figure 4: China NPI production



Source: Standard Bank Research, MBR

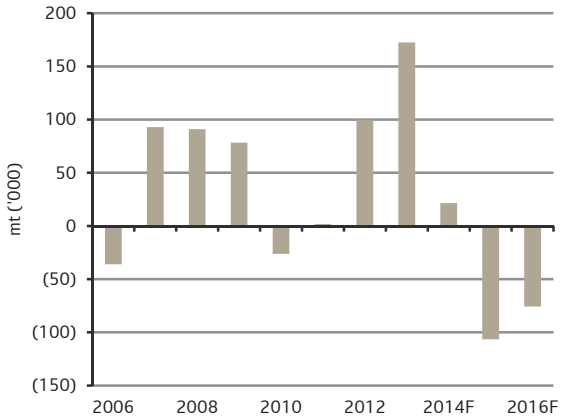
Refined inventories are, however, very high, while significant tonnages of refined metal continue to slosh about (see Figure 5). At the same time, we continue to forecast a surplus market for refined nickel (see Figure 6). A demonstration of just how much spare metal can be lying about was seen on the 18th of June when LME headline inventory increased by 19,242 mt, while on-warrant stock increased by 21,318 mt, split mainly between Rotterdam, Johor and Singapore. Whether the deliveries were finance-related, the transfer of a physical position (would account for some of the high quality premium material delivered in), the movement of metal from China/ex-LME to LME locations or a combination is still open for debate. The effect was to draw attention to the fact that LME nickel stocks are at near record highs and make up some 18% of market open interest.

Figure 5: LME nickel inventory



Source: LME, Standard Bank Research

Figure 6: Refined nickel market balance



Source: MBR, INSG, Standard Bank Research, WBMS

What will be interesting to see, and is still open for debate, is to what extent the refined nickel steps in to fill the gaps left by reduced NPI production. Looking at the regular pattern of warrant cancellation and re-warranting activity in Johor in particular, combined with limited outflows of metal at that location, suggests that a significant amount of metal there is tied up or held for financing purposes. Johor currently has about 150 kt of nickel, around 50% of total LME warehouse inventory.

With question marks over the immediate availability of at least 50% of LME inventory, how nickel premia react over the rest of this year will be an interesting aspect to watch. Likewise, the financing of significant warehouse inventory will also be interesting, though so far new longs coming into the market will undoubtedly help.

Looking ahead, it is really a case of how readily available refined metal is to fill the gap left by falling NPI output, or rather what price/market conditions are needed to liberate that refined metal? Also, how quickly can NPI facilities be constructed in Indonesia, and will there be any ore export concessions while those facilities are being built? Infrastructure is not in place to replicate the current EAF and RKEF furnaces in China, leaving blast furnaces as the quickest option. Potentially, decommissioned Chinese plants that fell foul of the pollution crackdown and/or falling nickel prices, could be packaged up and relocated relatively quickly.

It seems likely that nickel will consolidate and grind higher over the second half of the year

While these questions and options are worked out, it seems likely that nickel will consolidate and grind higher over the second half of the year, with the market looking at refined nickel availability and movement on the ore ban, while also factoring in higher NPI costs and looming deficits on the other.

Supply/demand balances for nickel

Thousands of tonnes	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Mine production											
Total	1 467	1 603	1 550	1 356	1 580	1 963	2 183	2 227	2 147	2 241	2 335
Year-on-year % change	5.8%	9.3%	(3.3%)	(12.5%)	16.5%	24.2%	11.2%	2.0%	(3.6%)	4.4%	4.2%
Refined production											
Africa	55	49	42	36	36	36	41	59	72	86	95
North America	147	154	168	117	105	142	140	137	139	147	153
Latin America	171	164	137	117	118	126	155	140	153	182	200
Asia (ex. China)	167	180	178	178	205	196	209	228	246	295	392
China	137	199	200	254	332	435	519	694	625	445	460
Australasia	163	156	142	168	141	150	174	190	202	259	280
Europe	512	514	510	444	502	522	515	497	487	492	482
Total	1 352	1 416	1 377	1 314	1 439	1 607	1 753	1 944	1 923	1 906	2 062
Year-on-year % change	6.0%	4.7%	(2.8%)	(4.6%)	9.5%	11.7%	9.1%	10.9%	(1.1%)	(0.9%)	8.2%
Refined consumption											
North America	155	145	137	98	130	141	145	148	156	161	163
Latin America	25	26	24	24	23	24	22	22	25	27	31
Asia (ex. China)	429	361	328	318	354	347	332	335	350	360	372
China	245	330	360	443	575	704	770	900	999	1 079	1 176
Europe	492	424	408	318	356	365	360	346	350	362	371
Others	42	37	29	34	27	27	27	25	27	28	30
Total	1 388	1 323	1 286	1 236	1 465	1 607	1 656	1 775	1 906	2 017	2 143
Year-on-year % change	11.3%	(4.7%)	(2.8%)	(3.9%)	18.6%	9.7%	3.0%	7.2%	7.4%	5.8%	6.2%
Implied surplus (deficit)	(36)	93	91	78	(26)	2	100	173	21	(107)	(76)
Stocks analysis											
LME	7	48	79	158	137	91	142	262			
Producer	81	89	98	89	90	96	87	88			
Consumer and merchant	6	9	11	15	18	20	22	20			
Total	94	146	188	262	245	206	250	369	390	284	208
Stocks as weeks of consumption	3.5	5.7	7.6	11.0	8.7	6.7	7.9	10.8	10.7	7.3	5.1
LME cash prices											
Historical & base case ($/tonne)	$24 287	$37 181	$21 074	$14 272	$21 809	$22 831	$17 571	$15 012	$17 526	$18 000	$19 200
Historical & base case ($/lb)	$11.02	$16.87	$9.56	$6.47	$9.89	$10.36	$7.97	$6.81	$7.95	$8.16	$8.71

Source: Standard Bank Research, LME

Zinc

We have the zinc market more or less in a modest 70 kt surplus for this year, before tightening further over 2015 and entering a deficit in 2016 for the first time in 10 years. While the general trend for prices is higher during this forecast period, inventories still remain high and we caution about getting too carried away just yet.

The latest data from the ILZSG suggest that the refined zinc market it's tightening up and was in a 107 kt deficit for the first four months of 2014. This was coupled with a 156.8 kt (16.8%) decline in headline LME inventory over the same period which has helped to shore up sentiment. SHFE Zinc inventory ended the Jan-April period, more or less unchanged at 70 kt, though stocks did peak at 93.7 kt in mid-March, before being drawn down again.

Chinese imports of refined zinc were 311 kt for the first five months of the year, up 27% y/y from the 244 kt imported over the same period in 2013, and not far off the level of imports seen in late Q3-Q4 last year. Given the prevalence of commodity-related financing activity in China, the surge in imports and the knock-on effect on Chinese apparent consumption can't be taken at face value, with some degree of stockpiling activity likely to have taken place.

Both SHFE and LME zinc inventories have since continued to decline over the course of Q2, with SHFE stocks falling below 50 kt and LME headline stocks dropping to 673 kt. LME inventory levels have averaged about 500 kt since the 1990's so there is still some room to go, the question being is that material being used and consumed, or is it merely going into off-warrant warehousing deals?

Zinc has come alive heading towards the end of Q2

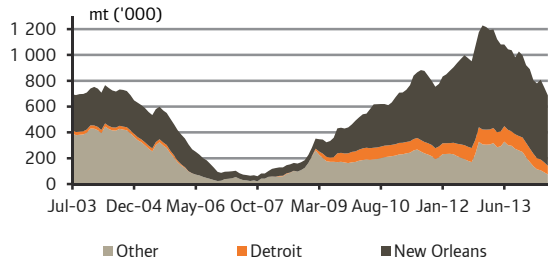
Zinc has come alive heading towards the end of Q2, with prices rallying back towards a 16-month high. The metal appears to be coming back in fashion amongst the speculative community with a positive fundamental picture from the ILZSG, reinforced by falling LME inventories.

Interestingly, open interest has remained pretty subdued, with the price strength coming in spite of relatively steady levels of market open interest. LME Select volumes are also pretty disappointing, with average daily turnover coming in at 9,430 lots/day so far this year, compared to 9,668 lots/day in 2013. The rally therefore appears to be a bit half-hearted in nature, though what does appear to have changed is that zinc is being traded on its own, or alongside lead, rather than against it as an RV pair.

Prices look like remaining on a firm footing heading into the summer

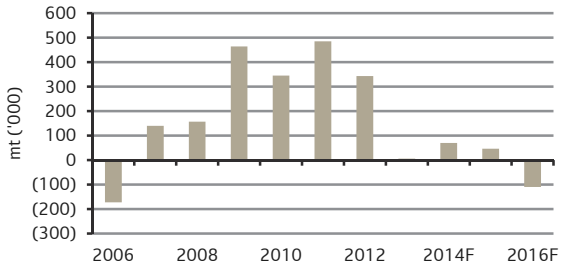
An improved technical picture may tempt the CTA community to jump the gun, though a degree of caution is still in place, given the lacklustre volumes and lack of change in open interest. Prices nevertheless look like remaining on a firm footing heading into the summer, though the real price strength is likely to be felt next year as the underlying tightness in the refined zinc market starts to be felt.

Figure 1: LME inventory



Source: LME

Figure 2: Refined zinc market balance



Source: MBR, Standard Bank Research

Supply/demand balances for zinc

Thousands of tonnes	2006	2007	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Mine production											
Total	10 447	11 203	11 882	11 601	12 354	12 644	13 130	13 203	13 612	14 007	14 315
Year-on-year % change	3.0%	7.2%	6.1%	(2.4%)	6.5%	2.3%	3.8%	0.6%	3.1%	2.9%	2.2%
Refined production											
Africa	257	279	265	270	273	246	167	148	150	153	155
North America	1 377	1 394	1 356	1 224	1 261	1 232	1 233	1 199	1 235	1 247	1 254
Latin America	486	480	482	427	554	642	603	627	645	657	656
Asia (ex. China)	2 512	2 500	2 543	2 526	2 712	2 816	2 839	2 910	2 965	3 036	3 091
China	3 163	3 743	4 042	4 286	5 209	5 212	4 881	5 100	5 508	6 004	6 484
Australasia	466	502	499	519	499	515	501	498	500	502	504
Europe	2 508	2 516	2 476	2 050	2 382	2 425	2 412	2 391	2 460	2 448	2 436
Total	10 769	11 414	11 663	11 302	12 890	13 088	12 636	12 873	13 463	14 048	14 579
Year-on-year % change	5.2%	6.0%	2.2%	(3.1%)	14.1%	1.5%	(3.5%)	1.9%	4.6%	4.3%	3.8%
Refined consumption											
North America	1 500	1 440	1 295	1 144	1 184	1 221	1 177	1 224	1 248	1 271	1 294
Latin America	406	417	432	340	432	429	386	384	407	440	466
Asia (ex. China)	2 578	2 533	2 578	2 381	2 669	2 604	2 665	2 810	2 866	2 895	2 953
China	3 225	3 562	4 145	4 659	5 403	5 458	5 343	5 748	6 093	6 580	7 120
Europe	2 786	2 852	2 626	1 939	2 489	2 513	2 355	2 351	2 422	2 452	2 485
Others	475	480	430	375	368	378	367	350	357	364	371
Total	10 970	11 284	11 506	10 838	12 545	12 603	12 293	12 867	13 393	14 002	14 689
Year-on-year % change	3.4%	2.9%	2.0%	(5.8%)	15.8%	0.5%	(2.5%)	4.7%	4.1%	4.5%	4.9%
Implied surplus (deficit)	(173)	140	157	464	345	485	343	6	70	46	(110)
Stocks analysis											
LME	91	89	254	489	701	820	1 221	931			
SHFE	0	54	63	172	309	364	311	239			
Producer	332	355	360	284	305	333	325	304			
Consumer	114	125	128	105	122	128	132	147			
Merchant	12	15	16	12	15	14	13	13			
SRB	0	0	0	159	109	109	209	254			
Total	549	638	821	1 221	1 561	1 768	2 211	1 888	1 958	2 005	1 895
Stocks as weeks of consumption	2.6	2.9	3.7	5.9	6.5	7.3	9.4	7.6	7.6	7.4	6.7
LME cash prices											
Historical & base case ($/tonne)	$3 273	$3 250	$1 873	$1 612	$2 159	$2 190	$1 960	$1 908	$2 109	$2 230	$2 500
Historical & base case (cents/lb)	148.5c	147.4c	85.0c	73.1c	97.9c	99.3c	88.9c	86.5c	95.6c	101.2c	113.4c

Source: Standard Bank Research, MBR

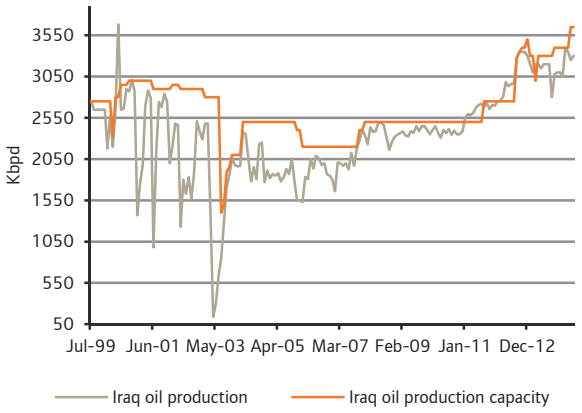
Crude oil

We expect Brent crude to average $109/bbl this quarter and $107/bbl next quarter

Oil prices have rallied on the back of supply concerns in especially Iraq and Libya. In determining how high the price can go, three questions are key: (1) how much oil production can Iraq lose; (2) how much oil production can Libya lose; and (3) can OPEC or someone else make up for this lost supply?

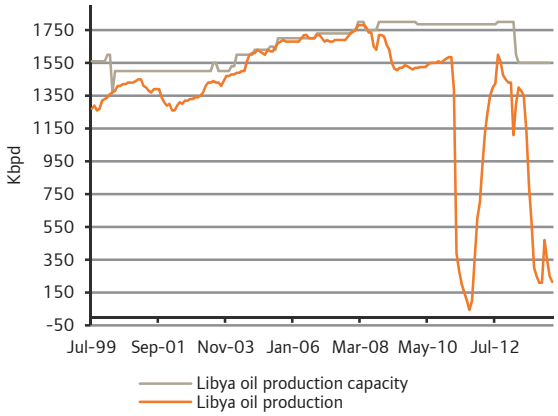
As of the end of May, Libya produced 180Kbpd of a potential of 1.55mbpd (Figure 1). This has steadily increased to 270kbpd by end of June. As a result, although Libya may see some decline in their production due to political unrest, the potential loss is not much greater than seen earlier this year. The bigger risk of course is in Iraq, which has produced around 3.2mbpd so far this year, and exported around 2.6mbpd (Figure 2). Clearly there is large downside for Iraqi oil production should unrest spread and make oil exports impossible.

Figure 1: Iraq oil capacity and production



Source: BP, Standard Bank Research

Figure 2: Libya oil capacity and production

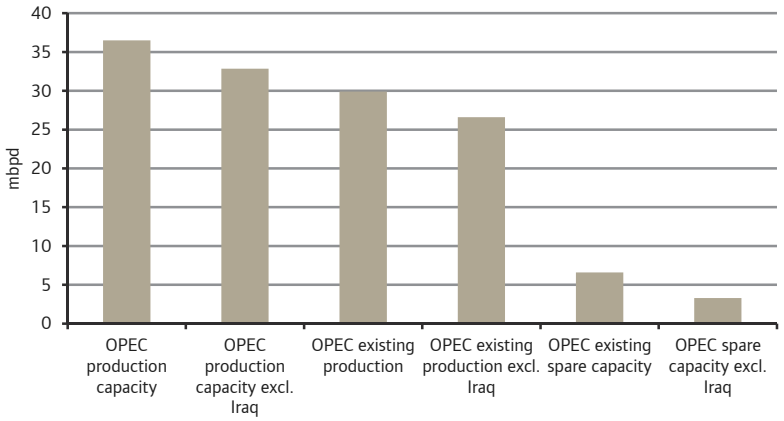


Source: BP, Standard Bank Research

As base case, we would work with potential OPEC spare capacity of around 4mbpd – still little, but not dire by any measure

This brings us to OPEC spare capacity. Currently OPEC production capacity, excluding Iraq sits at 32.85mbpd. OPEC's oil production is 29.95mbpd, leaving the cartel with spare capacity (excluding Iraq) at 4mbpd. Should Iraq's production of 3.2mbpd stop completely and OPEC needs to take up the slack, OPEC spare capacity will decline to only 3.3mbpd (from the current 6.6mbpd). In practice, OPEC's spare capacity should remain slightly higher since Iraq only exported 2.6mbpd of the 3.2mbpd they produced, i.e. implying actual spare capacity of 4.1mbpd (see Figure 3). This spare capacity in our view is enough to prevent oil prices from spiking higher and staying at elevated levels for a long period of time. However, we also note that it is unlikely that Iraq's oil production would fall to zero for extended period of time. During the Iraq War in 2003, production dropped to 140kbpd for only one month, where after it ramped up to around 1mpd quickly thereafter. As base case, we would work with potential OPEC spare capacity of around 4mbpd – still little, but not dire by any measure. OPEC has seen their spare capacity near 3mbpd a few times since 2009.

Figure 3: OPEC spare capacity, with Iraq in mind



Source: Standard Bank Research, BP

As a result, and assuming Iraq doesn't unravel completely, our view on oil remains largely unchanged; we still believe that Brent crude oil will remain well supported on approach of $100/bbl. However, we equally believe that demand over the next 12 months is unlikely to push crude oil on a sustainable basis above $110/bbl.

However, we equally believe that demand over the next 12 months is unlikely to push crude oil on a sustainable basis above $110/bbl

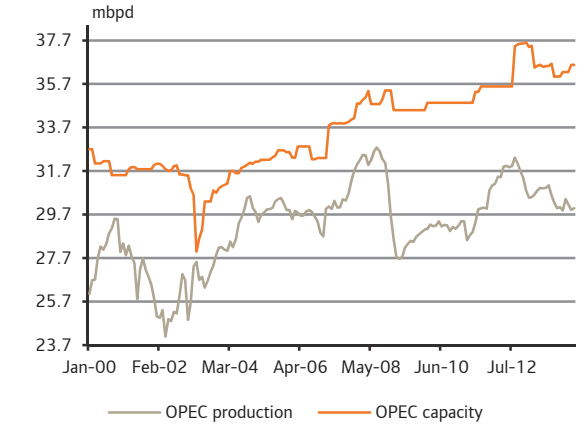
We expect WTI crude to average a $104/bbl in Q3:14next quarter and $108/bbl in Q4:14. We expect Brent to average $109/bbl in Q3:14, falling marginally to $107 /bbl in Q4:14. The forecast risk in our view, still lies to the downside especially if supply issues in Libya, and Iraq, ease.

Struggling growth in Asia offset by improving growth in the US

Oil demand has a high correlation with the OECD leading indicator which continues to show signs of improvement. We do believe that this uptick in economic recovery, driven by some extent by the US but also the EU (from a very low base), will support demand growth. Downside risk lies in the US, where rising long-term interest rates could affect discretionary spending of individuals in H2:14. As a result, WTI may be more vulnerable to a slide in prices than Brent from a demand perspective.

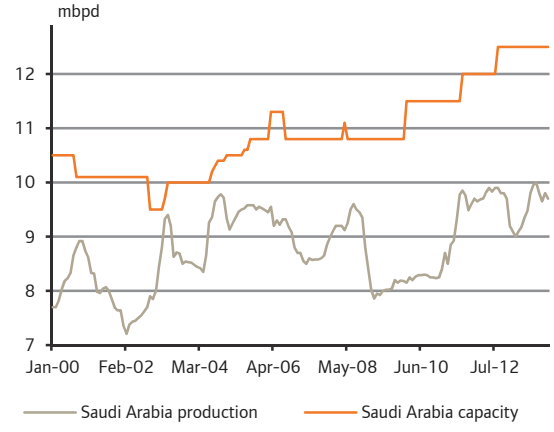
On the supply front, OPEC has expressed its comfort with current prices (choosing to maintain its production ceiling at 30mbd), leaving the oligopoly as a relatively neutral factor for now (see Figure 4). As pointed out above, this position may change if Iraq supply falls substantially. Ample OPEC spare capacity (currently at 5.95mbpd), as well as a relatively good compliance level by OPEC members (producing only 0.3mbpd more than the quota), should support prices on the downside, but free OPEC up to increase supply should it be needed. Furthermore, Saudi Arabia has at least another 2.75mbpd of spare capacity, and, given their willingness to increase supply in the past when needed, it may calm market fears about the possible tightness in the market in the event of further political uncertainty in the Middle East (see Figure 5).

Figure 4: OPEC production vs. capacity



Source: BP

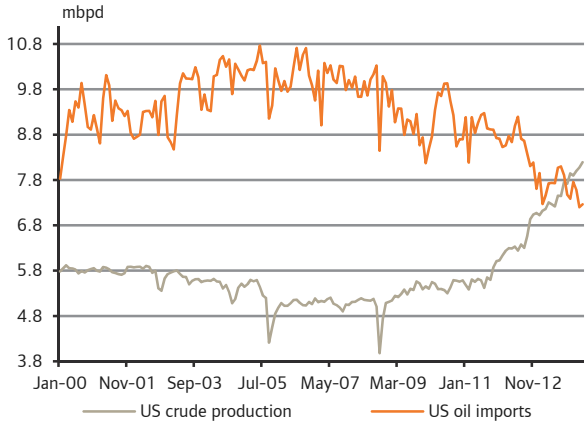
Figure 5: Saudi Arabia production vs. capacity



Source: BP, Standard Bank Research

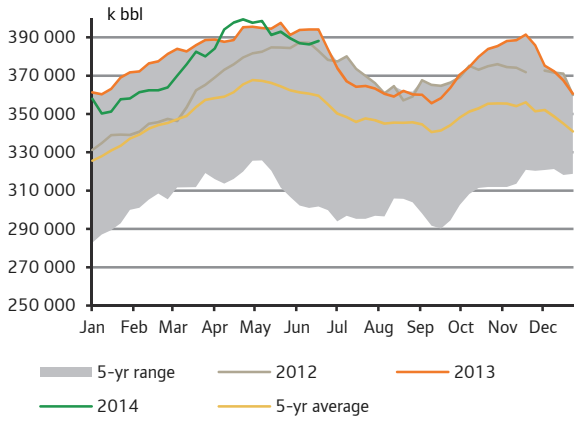
Overall, we believe the demand and supply picture from the US paints a less positive picture and it is from here that we see the largest risk to lower oil prices emanate. In the US, oil production continues to rise and imports continue to decline (see Figure 6). This in itself should see demand pressures ease in the global oil market. While crude inventories at Cushing have come off all-time highs and should continue to decline towards more normal levels seen in the past five years, total commercial oil inventories in the US remain near a five-year high (see Figure 7).

Figure 6: US crude oil production vs. oil imports



Source: US DOE

Figure 7: US crude oil inventories



Source: US DOE, Standard Bank Research

On the demand side, we believe that demand for crude oil in the US may be soft in coming months, partly because of fiscal policy, but also because we are not witnessing any substantial uptick in US highway miles driven. We use US highway miles as a proxy for discretionary driving and transport needs for the underlying real economy. Since 2008, there has been very little growth.

As always, China is a key driver of growth in oil demand

As always, China is a key driver of growth in oil demand. It is important that the economy has stabilised, but we also see a growing risk that the Chinese economy may underperform in terms of oil demand growth, largely because of growth that remains investment-driven as opposed to consumption-driven. Given that the largest part of crude consumption goes towards transport, slower growth in consumption would also imply slower growth in transport needs.

Supply/demand balances for crude oil

Key forecasts (millions of barrels per day)	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F	2017F
Demand	86.5	85.4	88.3	88.9	89.9	90.8	92.3	93.4	94.4	95.47
OECD	48.4	46.3	46.9	46.5	46.0	45.5	45.4	45.3	45.1	45.20
Non-OECD	38.1	39.1	41.4	42.4	43.9	45.3	46.9	48.1	49.4	50.00
Supply	86.8	85.4	87.5	88.6	91.0	92.1	93.3	94.5	95.6	95.00
Non-OPEC	50.7	51.4	52.7	52.8	53.4	54.3	55.2	56.2	56.9	57.00
OPEC oil and OPEC NGL	36.1	34.0	34.8	35.8	37.6	37.8	38.1	38.4	38.7	38.00
Prices ($/bbl)										
WTI	100	62	80	95	94	95	96	98	98	96

Source: Standard Bank Research, IEA

Thermal coal

Political tensions & interventions fail to fuel thermal coal

Thermal coal prices remained under pressure during Q2:14

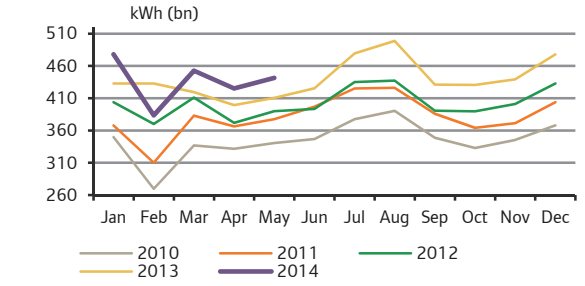
Thermal coal prices remained under pressure during Q2:14. API 2 averaged c.$75/t (Q1: $79/t); API 4 averaged c.$75/t (Q1: $79/t); while NEWC averaged c.$73/t (Q1: $77/t). In the Atlantic, a warm conclusion to the EU winter, coupled with neutral spring conditions, kept base-load demand under pressure. Ongoing structural competition from renewables, combined with certain power station maintenance disruptions (UK) and start delays (Germany), also impacted consumption volumes. Offsetting these trends, US coastal power plants - battling internal transportation difficulties after a brutal winter, which reduced both coal and gas stock reserves - increased their intake of Colombian materials by a small c.1mt. Geopolitical tensions also heated up. Ukrainian-Russian spats saw each side play to their strengths, trading-off sanctions for gas-supply reductions. Domestic Iraqi violence in key oil-rich cities also concerned global energy mix flows, although other OPEC members have calmed consumers, with little impact on Brent-coal arbitrage evident.

In the Pacific, although Chinese energy demand has averaged 5.7% y/y YTD growth and imports have remained relatively flat at c.22mt/mth, domestic coal consumption continues to be pressured by greater energy mix competition. Q2's peak hydro seasonal strength, coupled with expanding investments coming on-stream across all non-coal energy contributors, resulted in coal output barely growing in H1:14 (c.300mt/mth) & prompted local government support of up to RMB50/t ($8/t). Indian demand improvements in Q2, ahead of Monsoon (hydro Q3) season, seemed the key Pacific highlight on an otherwise heavily oversupplied seaborne landscape, with prices remaining under pressure. On the supply front, Drummond introduced its new Colombian direct-load port facilities in April, improving Atlantic supplies by c.5mt/qtr. RBCT shipped less in Q2 than in Q1 (-0.5mt/mth), still recovering stocks from the March electricity outage and Transnet's May rail maintenance, while loads were impacted by an oil spill in early-April. Australian volumes have remained consistent, recovering only 3mt on Q1's seasonal weather effects.

Prices will remain under pressure

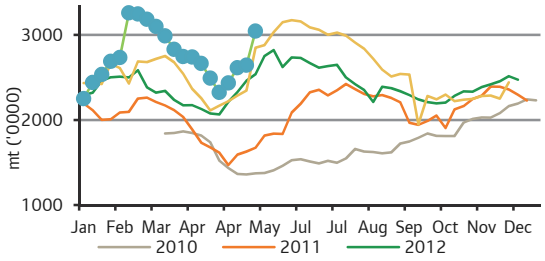
Prices will remain under pressure, with recent Chinese local miner subsidies of $5-8/t threatening to lower imports. Q2:14 benchmark NEWC settled with Japanese utilities at $81.80/t 6322 kcal/kg GAR (c.$77.60/t 6000 NAR) (Q1: $87.40/t; Q4: $85.80/t), with Q3 to settle $3-5/t lower. Some improvement in Q3 Chinese industrial demand may support a recovery in domestic NAR 5500 spot prices to RMB 530/t (c.$74-75/t S.China CFR) levels by Q4. The Pacific's LT outlook remains caught between Chinese/Indonesian supply dynamics and Chinese/Indian import arbitrage momentum. China's move to reduced LT coal dependency (from 70% to 65% of its energy mix) and India's plans to unlock local coal reserves challenge growth upside for seaborne suppliers. The Atlantic has further Russian and US materials waiting in the wings. We also see an ever-diminishing logic for API 4 tonnes to head north into the Atlantic, while watching the Panama's developments with keen interest. The LT outlook for thermal coal remains constrained, both by structural and cyclical factors, which continue to threaten coal's arbitrage future. With "C" a dirty word not only for the Europeans, but now also for the Chinese, we fail to envisage any significant price rallies, barring short-term Black Swan events (e.g. strikes; rebels; geopolitics) or typical seasonal squeezes. We see coal trading between $70-80/t.

Figure 1: China electricity production



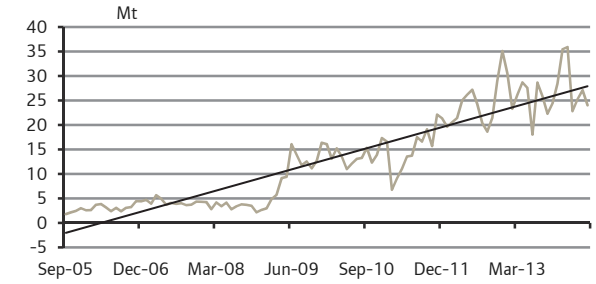
Source: China NBS, Standard Bank Research

Figure 2: China thermal coal port stockpile



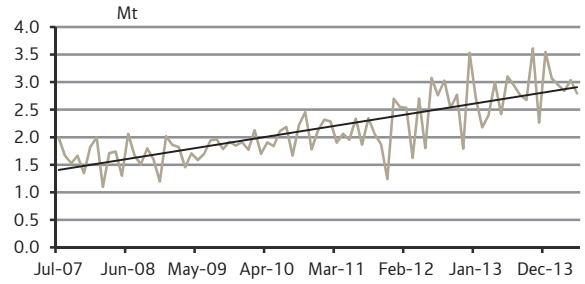
Source: Steelhome, Standard Bank Research

Figure 3: China thermal coal imports



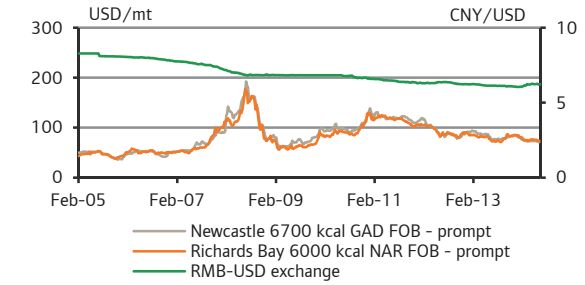
Source: China Customs, Bloomberg

Figure 4: Newcastle thermal coal exports



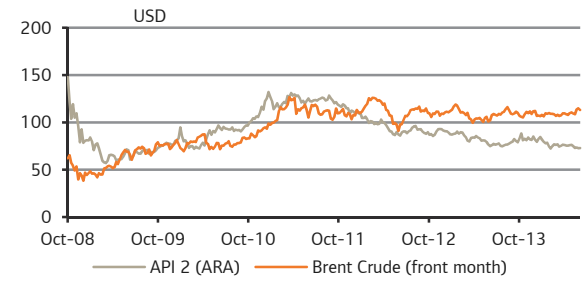
Source: Port of Newcastle

Figure 5: Pacific thermal coal prices



Source: McCloskey, Bloomberg

Figure 6: Atlantic thermal coal prices and Brent crude oil



Source: McCloskey, ICE

Supply/demand for thermal coal

Key forecasts (millions of tonnes)	2008	2009	2010	2011	2012E	2013	2014F	2015F	2016F
Seaborne Supply									
Australia	125.3	139.0	141.4	147.5	170.8	188.2	200.0	220.0	240.0
Indonesia	200.0	234.2	298.4	353.2	383.9	424.1	440.0	450.0	470.0
South Africa	65.3	67.3	71.0	70.9	76.5	74.3	75.5	78.0	80.0
Vietnam	16.9	24.1	18.0	22.1	17.4	13.1	12.0	10.0	8.0
China	41.8	21.7	17.8	10.9	7.8	6.2	6.2	6.2	6.2
Russia	0.8	11.8	11.6	10.6	20.2	27.3	30.0	35.0	40.0
USA	17.6	12.1	15.6	31.4	48.1	43.5	35.0	35.0	35.0
Canada	5.8	5.8	5.6	5.8	3.9	3.3	3.0	3.0	3.0
Colombia	60.7	67.2	70.5	77.5	83.7	84.9	91.0	97.0	100.0
Venezuala	3.5	3.8	3.8	2.7	2.0	2.0	3.0	4.0	5.0
Total seaborne exports	538	587	654	733	814	867	896	938	987
Year-on year % change		9.2	11.4	12.0	11.2	6.5	3.3	4.7	5.2
Seaborne Demand									
China	36.8	98.1	137.3	177.6	235.2	251.8	259.0	267.0	277.0
Japan; Korea; Taiwan	279.1	260.4	287.5	292.5	300.9	307.4	310.0	315.0	320.0
India	36.2	60.1	75.7	93.7	105.0	131.0	149.0	172.0	185.0
South East Asia	25.0	30.0	35.0	40.0	45.0	50.0	50.0	50.0	65.0
North America	30.0	20.0	16.0	10.0	7.0	7.0	5.0	5.0	5.0
South America	3.8	3.0	4.0	5.0	6.0	7.0	8.0	9.0	10.0
Europe	102.0	90.0	71.0	84.0	81.0	81.0	80.0	80.0	80.0
Turkey	14.9	15.6	17.0	19.6	24.6	21.5	24.0	28.0	32.0
Middle East	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Africa	2.0	2.0	2.0	2.0	2.0	2.0	3.0	4.0	5.0
Total Seaborne Thermal Imports	537.8	587.1	653.5	732.3	814.7	866.7	896.0	938.0	987.0
YoY Variance		49	66	79	82	52	29	42	49
% change YoY		9%	11%	12%	11%	6%	3%	5%	5%

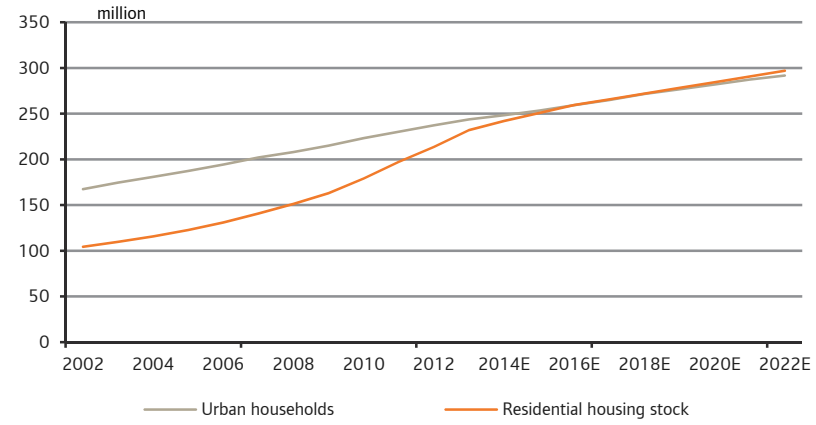
Source: Standard Bank Research, Company announcements

Iron ore

China's falling fortunes highlights Australia's supply glut

Iron ore prices in Q2:14 continued to suffer from China's ongoing debt reduction focus and its property sector's cyclical oversupplies, falling from Q1's $121/t to average c.$105/t in Q2. Chinese home sales have fallen nearly 10% y/y; residential starts and property construction are off 20% y/y. Floor space under construction has slowed from a growth rate of 30% y/y in 2011, to 11% y/y so far in 2014. We expect this to decline further to around 7% by 2016. Overall the pace of construction growth continues to decline as housing stock catches up with urbanisation. As construction growth slows, so will steel production growth (Figure 1).

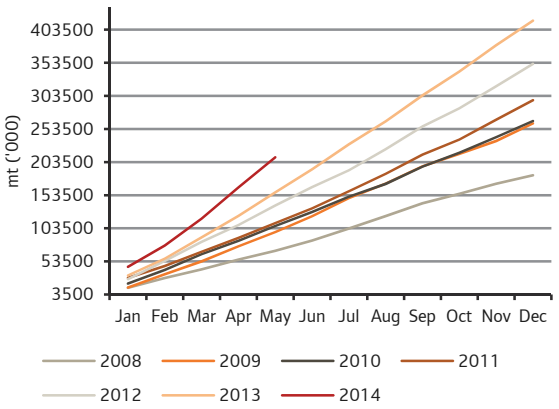
Figure 1: China residential housing stock vs. urban households



Source: Standard Bank Research

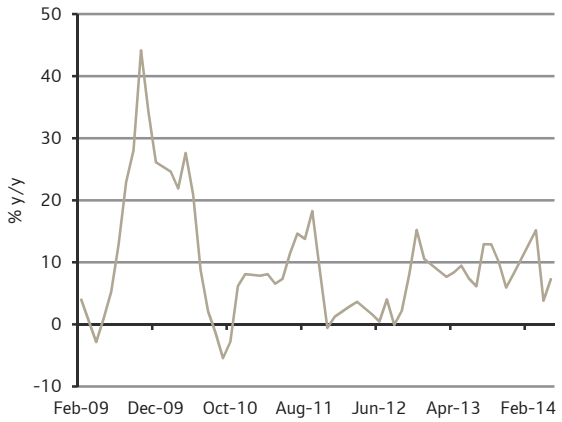
Resultant ore demand is averaging just 1mt/mth higher than last year or 0.35% y/y growth. For the first time since the financial crisis, Ex-China is pulling its weight, offering similar growth of 1mt/mth. Combined, global demand growth is generating just 1% y/y. Significant seaborne brownfield expansions, particularly by key Australian ore producers (up c.12mt/mth y/y), have more than offset this year's paltry demand growth. Even with the dislocation of higher-cost rivals, total supplies have risen c.
10% y/y (Figure 2).

Figure 2: China iron ore imports from Australia



Source: China Customs

Figure 3: China crude steel production



Source: China National Bureau of Statistics

Chinese miners have been the most impacted by the seaborne supply glut, with 120-150m of production forced to exit, together with smaller offshore suppliers. The c.4-6

week delay in closures relative to negative cash flow generation causes a short term mismatch between supply and demand, further exacerbating price falls.
More meaningful seaborne suppliers are also being forced to consider their options, with FMG's 50mt recent ramp-up at risk of killing both itself & the market.

Demand's typical seasonal downturn heading into June added to this de-stock momentum, further exacerbating steel and ore price falls

2014's falling fortunes for China's property, steel and ore industries have increased counterparty risks for financiers. Banks intensified of 2Q:14's supply destock by requiring higher deposits to open LCs; enacting monthly LC quotas and cutting overall lending levels. Industry consolidation has been a natural consequence, causing a permanent structural shift, by reducing the number of counterparties involved in the industry. Demand's typical seasonal downturn heading into June added to this de-stock momentum as steel inventory falling and iron ore inventory rising, further exacerbating steel and ore price falls (Figure 4).

Figure 4: China iron ore and steel inventory

Source: Steelhome, Standard Bank Research

2014's wall of seaborne supply is also causing other permanent structural shifts in industry dynamics: returns are dropping; the cost curve is firmly back in contention, with Chinese local government support of c.$5/t a possible threat. Within the higher grade Fe S-D bracket, units are relative well-balanced: tonne for tonne, gains equal losses.
In the lower-grade Fe categories, supplies (esp. from FMG) have outpaced demand growth, causing a widening in applied discounts, relative to Fe 62% ores. Lump premia have also been under pressure, with Q2 spot falling to just 4c/dmtu, below the full cost of sintering, largely due to the return of post-winter seasonal concentrate supplies. Improved sintering quality because of better higher-Fe DSO fines availability has lifted BF productivity, increasing the % consumed. Pellet premia have held up, assisted by higher Ex-China steel output rates. With new plants coming on-stream in Q3 (Samarco/Vale) and Q1:15's Minas Rio start to improve Middle Eastern DRI pellet supplies, we think premia will compress.

Price outlook

In our view, fair value for Q3 ore prices lies in the $100-105/t range. A seasonal re-stock, coupled with further mine closures for those unprofitable in the $100-110/t range, should see some of Q2's price dislocation due to oversupplies correct. Beijing's various mini-stimuli should also generate steel consumption support, particularly for infrastructure and social housing, noting that most new programmes will do little to assist property oversupplies, except in those few cities which have wound back home purchase restrictions.

Looking beyond, 2014's above-expected supply growth may reduce relative 2015 supply balances; however, overflows compared to demand will still be evident. The fortunes of China's property sector remain key to driving future ore demand growth.

Supply/demand balances for iron ore

Key forecasts (millions of tonnes)	2008	2009	2010	2011	2012	2013	2014F	2015F	2016F
Demand									
China seaborne	788	908	984	1069	1099	1181	1206	1242	1280
ex China	386	299	370	388	383	383	391	398	406
Total	1 174	1 207	1 353	1 457	1 482	1 564	1 597	1 641	1 686
Year-on year % change		2.8	12.2	7.6	1.8	5.5	2.1	2.8	2.8
Supply									
Indian	105.7	119.2	107.6	79.5	43.0	12.0	12.0	12.0	12.0
Australian	327.3	375.3	430.9	465.8	495.3	614.3	703.5	775.3	809.1
Brazilian	276.5	267.8	311.3	299.7	316.5	330.4	361.1	449.5	506.1
Other South America	13.5	16.4	24.2	35.1	30.9	23.2	30.2	34.5	35.5
South Africa	31.5	44.1	47.0	49.4	54.2	55.5	54.7	55.4	55.4
Other Africa	12.0	12.0	13.0	17.1	23.7	34.5	43.8	52.5	70.0
North America	19.7	19.7	19.7	25.5	34.2	34.5	42.1	45.7	57.2
Northern European	31.0	43.4	41.8	71.9	59.9	56.3	59.4	65.8	65.8
Other (Asia/Middle East)	14.1	16.7	22.8	34.9	37.3	35.6	36.0	36.0	36.0
China landborne	4.2	7.3	10.4	4.8	5.7	6.0	6.0	6.0	6.0
China domestic concentrates	326.7	255.0	350.9	359.9	351.3	353.1	236.0	107.0	53.5
Total	1 162	1 177	1 380	1 444	1 452	1 555	1 585	1 640	1 707
Year-on year % change		1.3	17.2	4.6	0.6	7.1	1.9	3.5	4.1
Seaborne theoretical totals	835.6	921.9	1028.7	1083.7	1100.5	1202.2	1348.7	1532.6	1653.1
Year-on year % change		10.3	11.6	5.3	1.6	9.2	12.2	13.6	7.9
China "available" imports	445	616	648	691	712	813	952	1128	1241
Fe 62% China CFR fines ($/mt)	152	86	151	171	128	135	108	105	98

Source: World Steel Association, Company reports, Standard Bank Research

Metallurgical coal

Product differentials rise as thermal crossover mounts

Met Coal prices began to see significant inter-product price differentials evolve in Q2, as oversupplies gathered momentum. Q2:14 Met Coal premium low vol spot prices actually remained relatively static with end-Q1 levels, averaging c.$110-112/t Qld FOB across the period, compared to $125/t for Q1 and $145/t for Q4:13. Q2 quarterly and monthly premia contract prices hovered in the $118-120/t range, with rollover expected into Q3, at best. Likewise, spot Tier 1 PCI spot prices stabilised around $95/t, with Q2 Tier I PCI prices settling at $100/t FOB ($116/t prior), and rollover into Q3 likely. However, spot semi-soft prices crunched all the way to $78/t, hovering just $6/t above NEWC thermal prices. As a result, while Q2 semi-soft prices settled for $90/t FOB ($103.50/t prior), at least $10/t compression is expected for Q3 contracts, with Chinese domestic miner subsidies to further threaten settlement levels. China's domestic coal oversupply, evident since mid-2012 as the country continues to shift its energy mix away from polluting thermal coal, has become as key to understanding met coal as steel consumption patterns.

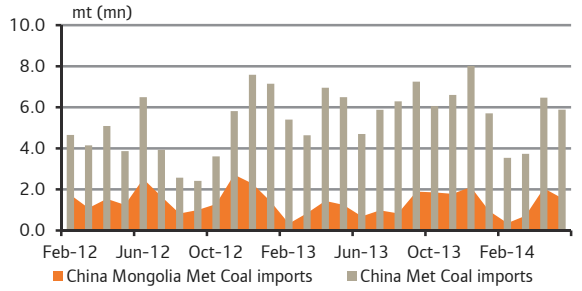
While met coal consumption growth has been evident in H1:14, demand in China grew at the anaemic rate of less than 0.5% YTD May (0.2mt). Ex-China growth was more visible, up 5.5% YTD May (3.4mt); however, rising competitive pressures from China's surging steel exports is curtailing Q2 momentum, relative to Q1, is likely to further dull H2:14 demand growth possibilities. Meanwhile, the underlying volume impact has been minimal, totally just c.2mt across H1.

High cost seaborne producers have been forced from the market, with several US and Canadian mine closures announced as we predicted, together with certain smaller higher cost mines in Australia. Others, such as the Mozambique shippers (c.0.5mt/mth), are generating losses; however, remain in the market for strategic reasons. Any exits are been overwhelmed by Australian expansions, such as BHPB's 4.5mt Daunia or 2.5mt Peak Downs additions, together with Chinese crossover thermal tonnes, always difficult to quantify with any accuracy. High Chinese port stocks over 13mt remain a consequence. Some miners continue to review their options, as they push to remove costs to improve their position on the cost curve, with even Take-or-Pay rail contracts are under review. Drops in freight (c.30%) and ongoing weak currency rates in 2014 have also assisted margins for miners, while the improving rupee has helped support Indian purchasing behaviour, with underlying demand up over 6%.

Price outlook

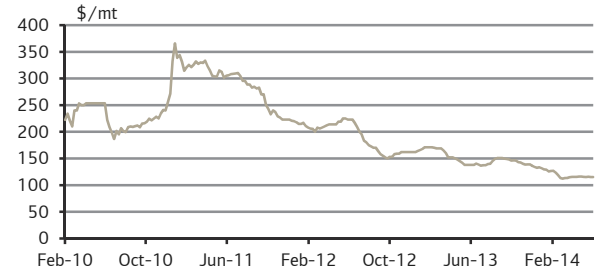
Prices remain almost entirely dependent on China. The country's weak property and thermal coal sectors, coupled with rising Chinese steel export competition all serve to retain Met Coal's anaemic price outlook for Q3:14. Any ex-China growth offers little support, given its disproportionately small size (c.250mt) relative to China's 4bn coal supply largesse. We expect an improvement in Q4 pricing as winter restock and the loss of domestic Chinese northern thermal and southern hydro tonnes improve domestic supply-demand balances. 2015 and beyond continue to look relatively benign, without Chinese thermal support, especially with Moz expansions due to enter the market from the upgraded Nacala corridor.

Figure 1: China coking coal imports



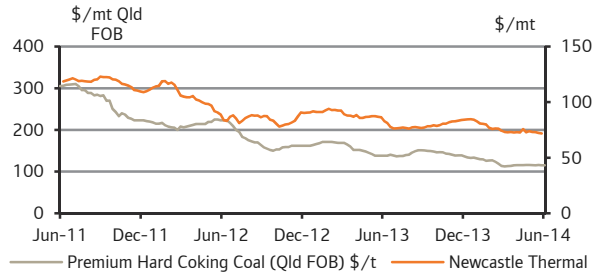
Source: China Customs, Bloomberg

Figure 2: Premium hard coking coal (Qld FOB)



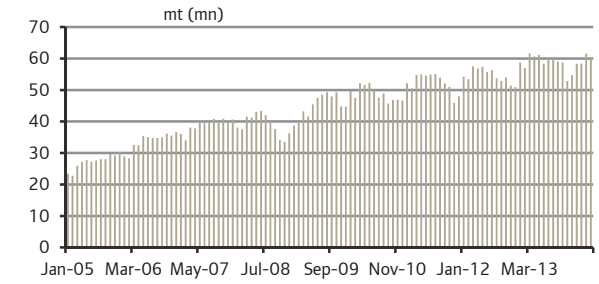
Source: Energy Publishing, McCloskey, Bloomberg

Figure 3: Hard coking coal vs. thermal coal



Source: Energy Publishing, McCloskey

Figure 4: Chinese pig iron output



Source: World Steel Association

Supply/demand for met coal

Key forecasts (millions of tonnes)	2008	2009	2010	2011	2012E	2013	2014F	2015F	2016F
Supply									
Australia	135.0	134.0	160.0	133.0	145.0	170.0	154.0	160.0	165.0
USA	38.7	34.5	52.0	60.0	60.0	56.0	50.0	40.0	30.0
South Africa	2.5	2.0	1.5	2.0	2.0	2.0	2.0	2.0	2.0
Indonesia	5.5	6.0	6.0	7.0	10.0	12.0	13.0	14.0	15.0
Canada	27.0	21.4	27.0	27.0	27.0	28.0	28.0	28.0	28.0
Poland	1.6	1.0	1.3	2.0	2.0	2.0	2.0	2.0	2.0
China	3.5	0.6	1.0	1.0	1.0	4.0	4.0	4.0	4.0
Colombia	2.1	2.0	2.0	2.0	4.0	6.0	6.0	6.0	6.0
Russia	13.6	13.2	18.0	19.0	21.0	23.0	23.0	23.0	23.0
Mozambique				0.5	2.0	6.0	10.0	15.0	20.0
Other	7.0	7.0	7.3	8.0	9.0	10.0	12.0	13.0	14.0
Total seaborne exports	237	222	276	262	283	319	304	307	309
Year-on year % change		-6.2	24.5	-5.3	8.2	12.7	-4.7	1.0	0.7
China domestic tonnage	325	345	365	402	410	430	451	474	492
Year-on year % change		6.0	6.0	9.9	2.1	4.9	5.0	5.0	3.9
Demand									
ex China seaborne demand	223	175	222	237	237	242	247	252	257
Year-on year % change		-21.8	27.3	6.8	0.0	2.0	2.0	2.0	2.0
China total demand	328	378	412	445	463	498	518	538	560
Year-on year % change		15.3	8.8	8.2	4.0	7.5	4.0	4.0	4.0
China seaborne imports	3	31	38	32	35	60	53	50	52
Australia hard coking coal spot fob ($/t)	319	156	220	273	192	151	120	128	135

Source: World Steel Association, Company Announcements, Standard Bank Research

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