Palladium: volatility rises, but the rally remains intact

After a whopping 54% intra-year increase during 2019, the start of 2020 has seen the palladium rally accelerate even further. From an opening of $1,945, palladium surged by 32% to $2,577 by the 20th. Over the period, the metal’s premium to platinum has also hit a series of all-time highs, exceeding $1,500 on the 20th. Following two weeks of successive gains, it was not surprising to see an almost $200 price correction over the past couple days. Liquidity has also been getting tighter, with lease rates shooting up and staying high even after this most recent correction.

The palladium rally has been driven by fundamentals

Palladium’s favourable supply/demand fundamentals remain the chief driver of the rally. After a decade of almost uninterrupted structural deficits, above-ground palladium stocks are estimated to have fallen to 12.7Moz by end-2019, down by 28% from 2010. In terms of demand cover, the decline was far more pronounced over this period. From roughly 24 months cover in 2010, inventories by end-2019 were only sufficient to satisfy 14 months of global palladium demand.

More importantly, a large portion of these stocks are not readily available to the market. Some are locked into work-in-progress inventories, are part of strategic stockpiles held by OEMs and other users, or relate to precautionary purchases by Chinese market participants. This is in sharp contrast to the situation of a few years ago, when a sizeable amount of stockpiles were held by professional investors, who tend
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to quickly respond to price movements. In fact, liquidations from the investor community (such as ETP redemptions and a cut in net Nymex longs) have been an important source of supply to fulfil market deficits in recent years. That said, with a massive reduction in the investor overhang, the scope for further liquidations have become increasingly restrained. This perception is also supported by anecdotal evidence, with most of our contacts confirming they see professional investor participation being far lower than during previous rallies.

Palladium automotive demand set to continue growing this year

Despite a major decline in global vehicle sales last year, palladium autocatalyst fabrication still recorded a 2% lift, after tightening emission limits led to an increase in PGM loadings, particularly in China. Going forward, growth in palladium autocatalyst demand is forecast to accelerate this year, as the automotive industry slowly bottoms out and more stringent emission standards fuel ever higher PGM loadings.

With palladium’s widening premium to platinum, the question of substitution between the two metals has become a key topic. However, we are so far not aware of a switch being made at a commercial level. A number of factors have restrained such as a shift, relating to palladium’s superior performance at higher temperatures, R&D budgets being focused elsewhere (for example, on electrification) and the fact that, even at current prices, the net gain of partially switching palladium in a gasoline system to platinum is modest for most models. Also very importantly, we believe that, having come out of a series

Palladium Autocatalyst Demand

![Graph showing Palladium Autocatalyst Demand](image-url)
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of emissions scandals, OEMs are likely to accept the higher cost of palladium to avoid risking non-compliance (for instance if a platinum-loaded solution fails to perform to expectations in the real world).

**Scope for supply growth in 2020 is restrained**

The majority of palladium’s supply components are also price inelastic. Total supply, for instance, rose by only 17% over 2010-19, during a period when the palladium price tripled. Turning to 2020, mine production is forecast to edge slightly lower. Moreover, continued issues relating to power supplies in South Africa have also raised risks of temporary supply disruptions. Palladium recycling from spent autocatalysts is also forecast to ease back, as last year’s record volumes was also boosted by heavy de-stocking by scrap yards, which is unlikely to be repeated to the same extent in 2020.

**Where next for the palladium price?**

In the very near-term there certainly seems to be scope for further corrections in the palladium price. The forthcoming Chinese New Year holiday, possibly coupled with the impact of the coronavirus crisis that is developing, could affect short-term demand from what is now by far the biggest single palladium consuming nation. Finally, if concerns about Eskom ease, that could also weigh on prices.

All this however would be short-lived. Overall, Metals Focus expects the structural deficit to double in 2020, to a four-year high, pointing to an increasingly tight physical market. Against this backdrop, we are confident that the palladium rally will continue this year.
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Gold:Silver Ratio

Source: Bloomberg

Gold:Oil (Brent) Ratio

Source: Bloomberg

Platinum-Gold Discount, US$/oz

Source: Bloomberg

Platinum-Palladium Discount, US$/oz

Source: Bloomberg
Charts - CME Futures Net Positions*

Gold

*Managed money positions; Source: Bloomberg

Silver

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**Gold**

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