COMMODITIES UPDATE

24th Jun. 2016

UK vote for 'Brexit' not a game-changer for commodities

- **The UK's vote to leave the EU has predictably undermined the prices of industrial commodities, including oil (which initially fell by around 5% in US dollar terms) and copper (-3%), while boosting those of safe havens such as gold (+5%)**. However, these moves are already starting to unwind. Once the dust has settled on the shock result, we suspect that the prospects for all these commodities will be determined by other, more specific factors.
- We looked at the potential implications of a UK vote to leave the EU in an earlier *Update*, "What would 'Brexit' mean for commodities?", published on 9th June. It was always likely that the negative impact of a Brexit vote on business and investor confidence would feed through into lower prices for riskier assets of all types, including industrial commodities. However, **oil and industrial metals have held up rather better than equities, particularly in the euro-zone**. (See Chart 1.) This makes sense, as the prospects for oil will continue to depend far more on developments on the supply-side and on the health of the global economy, rather than what is (so far) only a local problem in Europe. The same point applies to copper and other industrial metals, with a particular emphasis here on what happens in China.
- What's more, **the market panic in the wake of the UK vote is already beginning to fade**. In part this is because global officials have shifted their rhetoric away from talking up the risks of Brexit (in what was an ultimately unsuccessful attempt to influence voters) towards more positive comments designed to restore confidence. It is also becoming clearer that the UK will remain a member of the EU for several more years, allowing time for negotiations to resolve at least some of the uncertainties over issues such as the arrangements governing trade. **Admittedly, pressure for referendums in other EU countries is now growing, but this will be a slow-burner rather than an immediate threat**.
- We therefore expect other factors to take over again as key drivers of industrial commodity prices soon. In the case of oil, **we reiterate our view that the price of Brent will end the year slightly lower, at around $45** (compared to $49 currently). This is based on the assumption that the global oil market will take a little longer to rebalance on a sustainable basis, plus some fresh dollar strength, rather than specific Brexit risks. **As for copper, we expect a renewed rally to around $5,500 per tonne by end-2016** (from $4,650 today), supported by better economic news from China.
- In contrast, the price of gold jumped in the wake of the Brexit vote, again as had seemed likely. (See our *Precious Metals Update*, "How big a boost might 'Brexit' provide to gold?", published on 10th June.) This reflects both the expectation that interest rates will now be kept lower for longer, including in the US, and gold's traditional role as a refuge from uncertainty. Indeed, **the price of gold has recently been closely correlated with other safe-havens, such as the Japanese yen**. (See Chart 2.)
- We would not therefore be surprised to see gold hit our existing end-2017 target of $1,400 per ounce much sooner if market jitters do continue to grow. However, **if we are right that the vote for Brexit is not the global shock that many fear, US interest rate hikes could soon be back on the agenda**. Gold should still do well in this scenario, buoyed by growing appetite for inflation hedges and robust demand from emerging economies, but clearly not as well as if the world were indeed heading for disaster.

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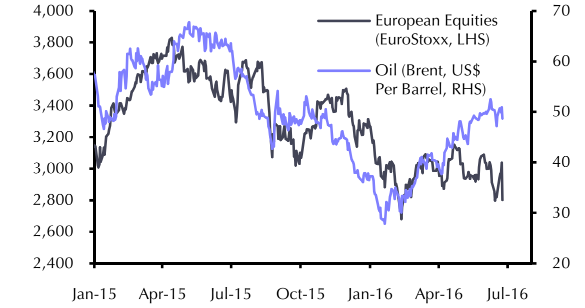
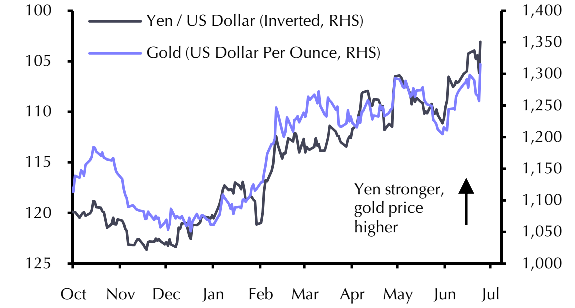
Chart 1: European Equities & Oil Price



Source – Bloomberg

Chart 2: Yen & Gold Price



Source – Bloomberg