

The Japan Fiasco and Its implications for Precious Metals Markets

The recent tsunami and earthquake in Japan in March 2011 caused a flutter in precious metal market moves. A detailed analysis of Japan's precious metals sector could illustrate the possible market impacts of the tsunami in the current day. To what extent did the slump in industrial demand caused by the disaster affect the platinum and palladium markets?

What are the future implications of the tragedy on precious metal prices today? Which duo is more sensitive to the Japanese debacle: gold/silver or platinum/palladium?

We have seen active discussions in precious metals forums/blogs on the Japan disaster and its possible impacts on the sector. Most conversations concluded in a negative note about Japan's fundamental support to the precious metals market, projecting a lower demand from the country. Why was there such an interest among precious metal traders in the Japan disaster? Does Japan play such a vital role in driving the precious metals market? Do the markets still remember the Japanese downside?

As written in the Premium Updates from the time of the tsunami: "anything said or written about the tragedy in Japan must begin with the disastrous scale of the country's human loss. The people of Japan have suffered thousands dead or missing, hundreds of thousands homeless, whole villages and towns wiped out. It seems too much for any one country to take."

Soon after the disaster struck the precious metal prices plunged (platinum and palladium in particular) many traders were too late to sell those metals. Disruptions to the Japanese auto industry, a vociferous consumer of electricity, and to the electronics sector were the primary concerns that

resulted in a negative momentum in the prices. However, gold and silver prices were less affected by comparison.

The calamity had severely impacted the economical status of the country. Goldman Sachs reported a \$200 million-per-day loss to Japanese automakers due to tsunami induced shutdowns. Auto sales in northeast Japan plunged 40% while the western region experienced a slip of 20%. Consequently, many international agencies including OECD declared a downturn revision in GDP growth forecast citing as the country may take as long as five years to get back to better economic levels. The OECD slashed Japan's 2011 GDP growth forecast to 0.8%, from a previous estimate

economy – the quarterly GDP numbers in 2012 have been at levels seen before the earthquake. The economy had to shrink in 2011 but when one factors in the cost of the damage, one would be more buoyed by the upturn following the earthquake than the downturn during the rebuilding process.

Is the Tiny Island a Crucial Factor Determining Precious Metals Direction?

Where does Japan stand in terms of precious metals demand? Based on GFMS estimates, Japan represents approximately 2.4% and 9.6% of gold and silver demand, respectively.

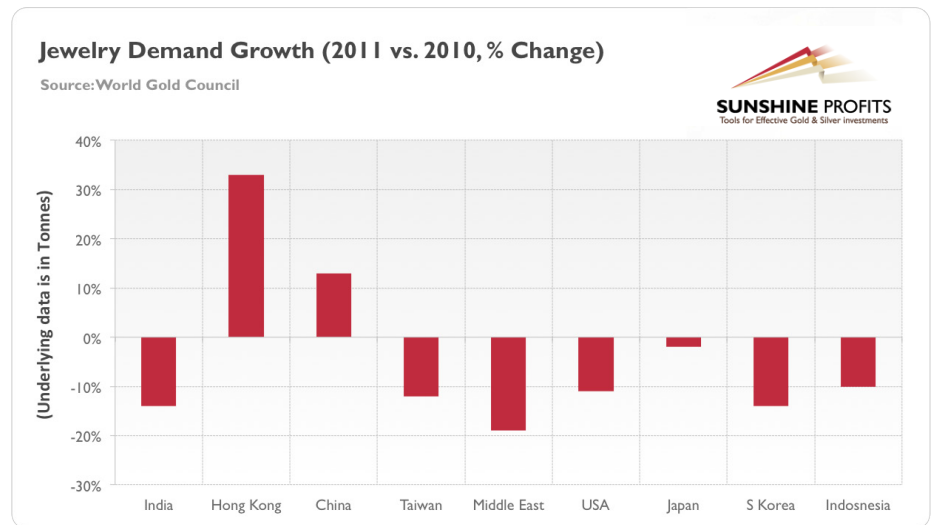


Chart 1: Jewelry Demand Growth

of 1.7%, after the disaster.

However, Japan's auto production crawled back to normal quite fast – within six months of a shattering catastrophe, Japan's automotive industry had started a rebounded and within a year was within normal levels seen before the calamity. Japan's resilience has also been witnessed in a reviving

All that Glitters is Not Gold in Japan

Japan's central bank is the world's 8th largest holder of gold. As in other regions of the world, gold is treated as a safe investment. However, the use of gold in jewelry has been historically very limited compared to investment. Gold jewelry is not popular among Japanese, as evident from the annual negative growth rate in jewelry demand (2010 vs. 2009). However, in recent times there has been evidence of a growing trend of Japan's increas-

Global Gold Consumption Intensity, 2009

Source: GFMS, IMF, WGC Estimates

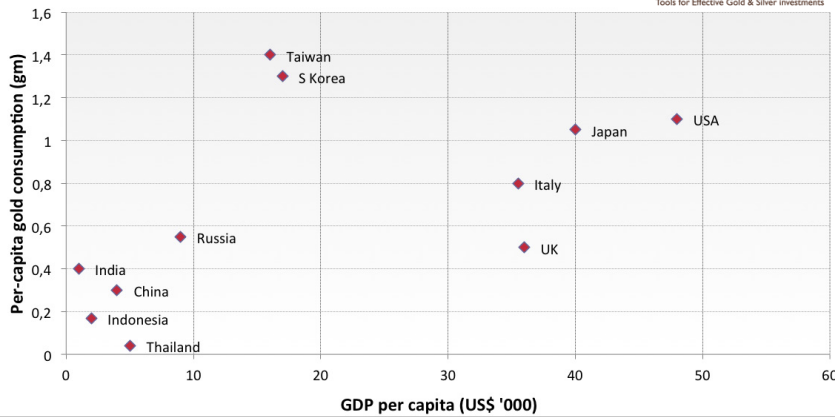


Chart 2: Global Gold Consumption Intensity, 2009

ing interests in gold jewelry. Despite the dampening effect of the tsunami, 2011 witnessed jewelry demand in only 2.3% below 2010. Q3 and Q4 in fact registered record jewelry demand not seen in years. In terms of gold consumption intensity (taking into account industrial and jewelry consumption), Japan ranks one of the top countries, indicative of higher investment demand. To boost precious metals investments, Japanese launched coin and ingot vending machines and the sales appear promising.

In 2010, the annual gold demand was almost at the same level compared with previous year values (¥64 bn). However, the fourth quarter of 2010 experienced a severe hit in gold demand. As World Gold Council reports, profit taking continued

to outweigh fresh investment purchases in Japan during 2010. On the other side, fresh investments were fuelled by economic concerns and an improved awareness of the positive benefits of having gold as a part of a diversified portfolio (Chart 1 and Chart 2).

Japan is a net-exporter of the yellow metal. Japan's gold exports were only 2.3% of global supply in 2010 (2.7 million ounces in figures, according to the World Gold Council) and the majority of its exports were concentrated in Asia. Exports have been on a steady rising curve ever since Japan became a net exporter in 2006. For the fiscal year ending Mar 2011, exports were reported at 4.3 million ounces – a staggering 61% jump from the prior year. All this despite the tsunami crisis that had

stalled Japan in 2011! With exports set to remain healthy and on the upside, there does not seem to be concerns of strain on the Asian gold supply – not significant enough to impact prices.

Supported by a top position in technological developments, mostly in electronics, there is heavy industrial use of gold in Japan. Moreover, Japan accounts for approximately 6% of global gold fabrication demand.

Overall, investment demand for gold remains high in the country; however, gold jewelry demand appears weak (though rising). In terms of overall consumption and exports, Japan is not very visible in the global picture. Put another way, lower demand from Japan cannot hinder high price momentum in gold prices because gold is affected by a series of factors including currency, economic stability and surging demand from BRIC nations. Although Japan's per-capita gold consumption is at higher levels, the 2011 calamity can only impact the market for the short-term, as has been observed. Therefore, any residual impact from the disaster on gold prices is ruled out in the upcoming months.

On a Consumption Scale, Silver Outshines Gold in Japan

Japan's role is more influential when it comes to silver, because of its high industrial use. How is this going to affect the market in the coming months? Does Japan have a front seat in driving silver prices?

Japan accounts for more than 9% of global silver demand. Undoubtedly, industrial demand for silver is the primary factor that establishes the link between Japan and silver market.. Major industrial segments that illustrate Japan's silver demand include electronics, automotive, construction, food packaging and medical sector. Moreover, advanced technologies that use superconducting materials as power cables would cause additional demand for silver in the upcoming years (Japan's first power grid using superconductor cables is slated for testing this year!).

In general, other prominent segments that could affect silver consumption are silverware and photography. But GFMS predicts a weak performance in these industries in the coming years, due to lower demand (Chart 3).

Global Silver Industrial Fabricators, 2010

Source: GFMS

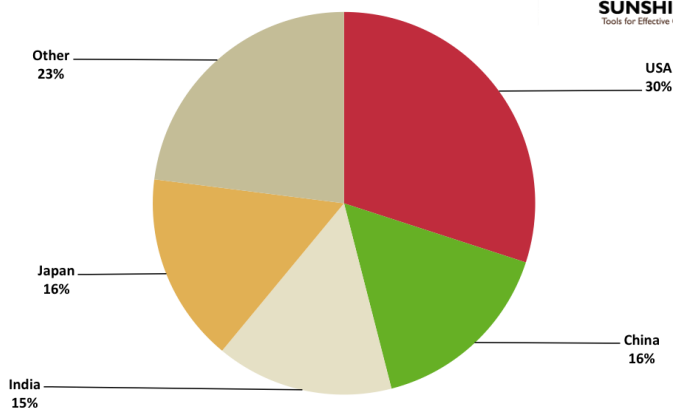


Chart 3: Global Silver Industrial Fabricators, 2010

Globally, the US, the EU and Japan to

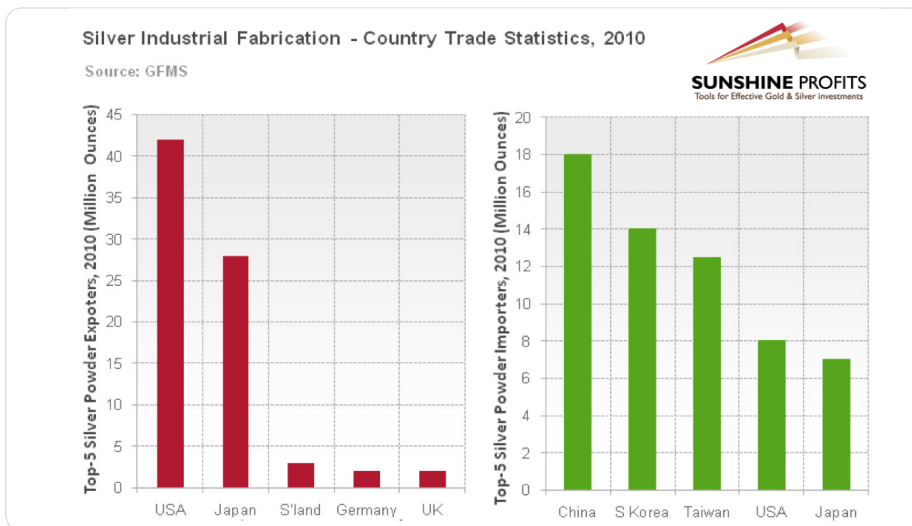


Chart 4: Silver Industrial Fabrication - Country Trade Statistics, 2010

gether account for more than 50% of silver industrial demand. Silver demand from electrical and electronics industry is driven by the US, Japan and China. The primary focus in Japan's industrial silver demand is the extensive use of silver in solar photovoltaic (PV) cells. Supported by the PV segment, demand soared more than 100% over the past two decades. Although the industry had a severe hit during the recessionary period, recent developments on the technological front and improved export demand indicate potential growth prospects for Japan. Another industrial segment that requires silver is Ethylene Oxide (EO) manufacturers.

Based on the overview given above, let's detail the impact of Japan's disaster on the silver market. With an upper hand in industrial use when compared to gold, it's evident that Japan plays a prominent role in affecting silver prices. Exacerbated industrial demand and a complicated delivery as a result of the debacle impacted silver market to a higher extent than it did gold. Therefore the conclusion is, yes, lower demand after the disaster in Japan impacted silver prices - evidence being that silver prices stalled a significant rally within a month or two of the disaster. However, the silver market can withstand the downtrend to a certain extent supported by gold and currency markets. But the question remains, how is the crisis going to affect the market in the near-future? For that we have to look at two scenarios: a) resumption of industrial operations, and b) silver availability in Japan.

Most of the companies that were closed fully or partially due to the earthquake and following blackouts have re-started their

operations. With the progress in power/ electricity stability and refurbishing, most production units were fully operational in a month or two. Industrial demand for silver has been restored to normal levels quite promptly in Japan and that should not impact prices going forward.

On the Japanese supply side, the country not only depends on its own mines for silver production, but relies heavily on imports. If you look at the import/export statistics of silver powder, Japan is one of the top countries in terms of both silver imports and exports; the US is the largest silver powder exporter to Japan. In terms of availability, Japanese industries did have a short supply situation immediately following the 2011 crisis, but supplies restored to normalcy once the delivery route became functional.

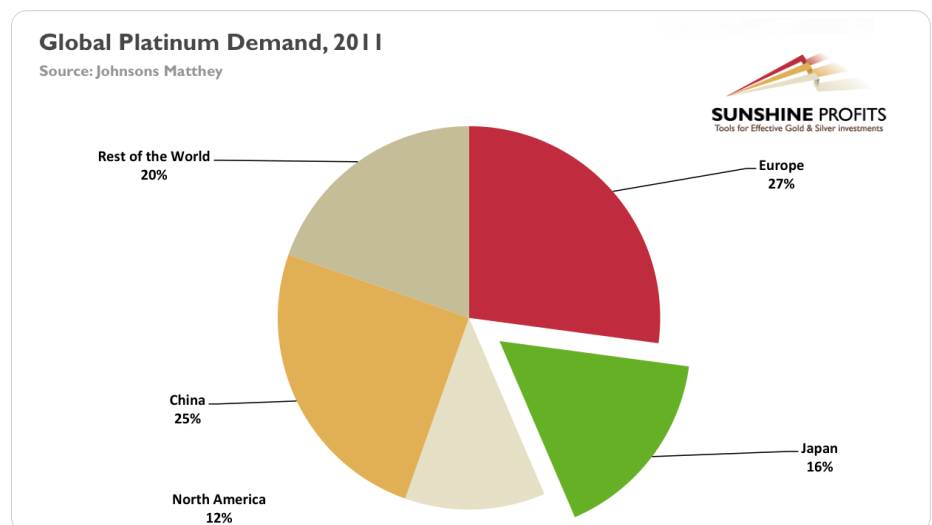


Chart 5: Global Platinum Demand, 2011

(Chart 4).

Overall, it can be concluded that the wash-out in Japan definitely added to silver price fluctuations, a factor that stalled the silver rally immediately. Though silver prices dipped due to the Japanese disaster, it's difficult to explain this downtrend with the disaster alone. It makes more sense to say other factors such as currency, gold and macroeconomic data also impacted the price moves. Therefore, it appears that 'Japan' is already factored in silver prices and in fact, chances of the silver market going up are very high with improvements in industrial consumption of silver in Japan in the near future. Impacts of 2011, of whatever significance, are no longer a factor.

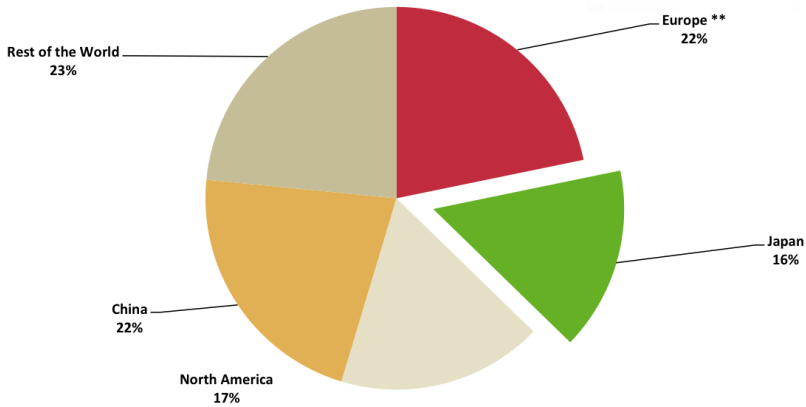
Considering the role of Japan (as a burgeoning auto manufacturer), gold and silver account for only a small fraction of global demand. But the country plays a significant role in platinum and palladium markets. So, let's move on to these metals.

Platinum and Palladium Enduring Japan's Fiasco

Platinum and palladium markets had experienced a severe hit soon after the tsunami and earthquake in Japan as evident from the price charts. Speculations of a reduced demand (in fact, a zero demand) from Japanese automakers were the primary reason behind the dip in prices. The Japanese auto industry is a top concern for platinum and palladium demand, globally. Reduced demand from Japanese automakers and a fall in industrial activities (automobile and electronics sectors) pres-

Global Palladium Demand, 2011

Source: Johnsons Matthey



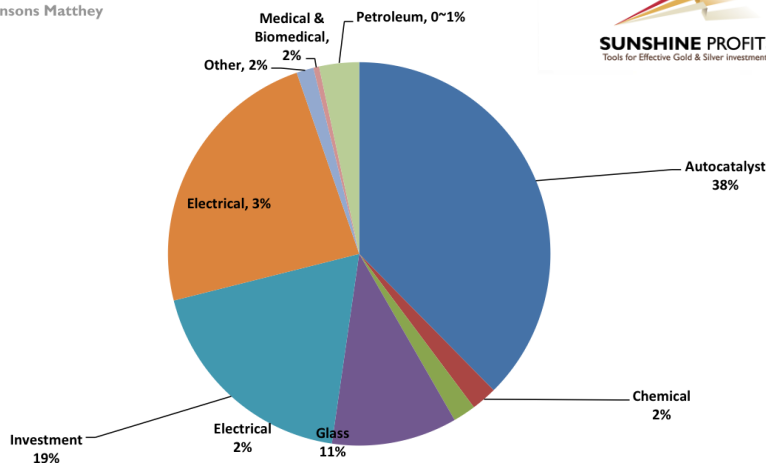
Overall, production curbs in Japan due to the disaster significantly impacted demand for the metals and prices fell off a cliff. However, the prices rebuilt later. The downturn in the palladium market was greater in comparison with platinum moves. Greater use of palladium over platinum in autocatalysis explains this scenario.

Do these incidents really mean that the overall global demand for PGMs dried up? It seems like it, but no. Put it this way: the Japanese demand for PGMs does not appear weak at this moment because of the relatively quick recovery of the auto industry.

Chart 6: Japan Palladium Demand, 2011

Japan Platinum Demand by Segment, 2011

Source: Johnsons Matthey



Platinum and Palladium: Japan's Precious Metals

Before digging into market fundamentals, look at the price movements since the tsunami hit Japan. Although platinum had drowned to sub \$1,700 levels soon after tsunami, it regained substantially within a month. Similarly, palladium prices also made a good recovery from the crisis induced downturn toward under \$710 per ounce.

Among precious group metals, highest fluctuations were seen in platinum and palladium markets due to the Japanese fiasco, primarily because of the extensive use of these metals as auto-catalysts. Japan accounts for approximately 30% of the global automobile output and is one of the top consumers of platinum jewelry. On a global scale, Japan accounts for approximately 15% and 19% of platinum and palladium demand, respectively. The below figures clarify how Japan is linked with

Chart 7: Global Platinum Demand by segment, 2011

sured PGM markets severely.

Many companies including Toyota, Honda, Nissan, Ford and Chrysler Group had to cut down their production, or forced to delay deliveries. The primary cause for the low output were power outages in production units and unavailability of automobile parts from other companies. There was a ripple effect across the global automobile supply chain when the motor vehicle assembly capacity in Japan (where Japan accounts for nearly 14% of the global figure) was interrupted due to the crisis. Although the major companies including Toyota and Honda resumed their operations gradually, in most of the production units in Japan, production curbs in North American and European sites still pressured the industry for a significant time.

Global Platinum Demand By Region, 2006-2011

So ROW China India Japan Europe

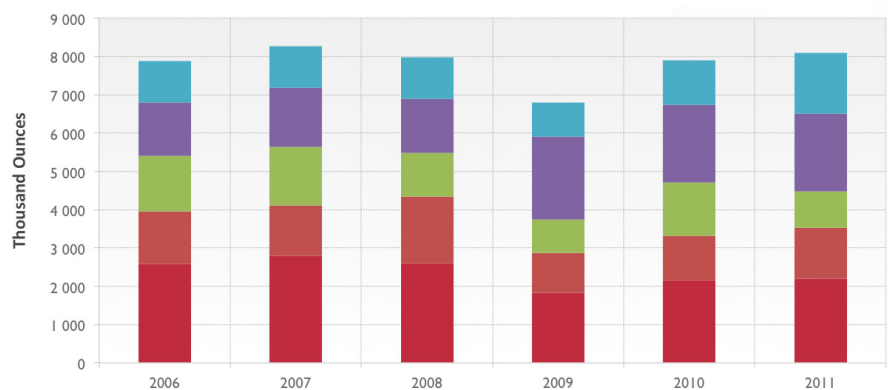
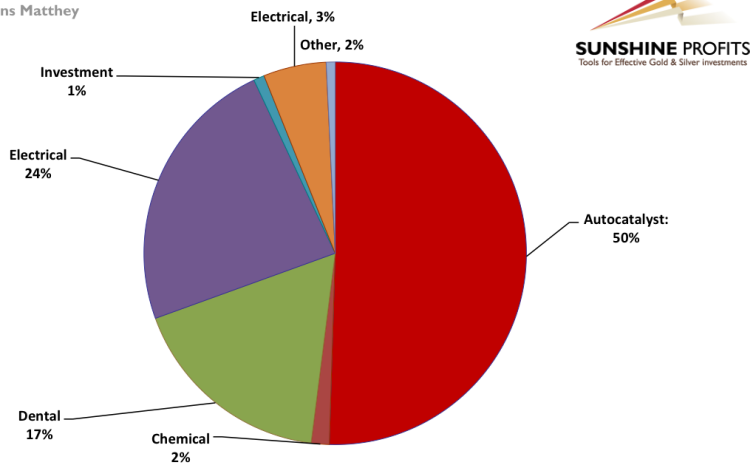


Chart 8: Japan Palladium Demand by Region, 2006 - 2011

Japan Palladium Demand by Segment, 2011

Source: Johnsons Matthey



palladium is in the electronics industry, worldwide.

- However, the electrical segment in Japan accounts for only 5% of the domestic demand.

All these numbers/charts confirm Japan's vital role (in terms of demand) in determining the direction of platinum and palladium markets. It is evident that the non-equilibrium demand scenario soon after the debacle dragged the market down. However, as indicated before, the market digested this incident quickly and recovered within days. This prompts another question: how is the natural disaster going to affect these figures in the long-term i.e. now? Although Japan plays a vital role in platinum and palladium markets, alternatives could support demand.

Chart 9: Global Palladium Demand by Segment, 2011

market direction! (Chart 5)

Strong industrial and jewelry consumption corroborates the domestic demand among the influential factors for the platinum market. In 2010-11, Japan's autocatalytic platinum demand was resilient at 18% of global numbers (in fact, the amount of platinum or palladium required in one vehicle is just a few grams!). It is to be noted that the 16-18% share of global value (nearly 0.53 million ounces in 2010) has been almost constant during the past few years, where Europe and the US witnessed a significant decline in their global share. Firm demand for platinum ornaments (approximately 0.3 million ounce demand in 2010 and 2011) also confirms the upper hand of Japan in platinum market fundamentals (Chart 6 and Chart 7).

platinum and 1.31million ounces for palladium.

- While industrial demand for platinum registered 0.72 million ounces in 2011, that of palladium was 1.23 million ounces; auto-catalysis accounts for more than 50% in both the cases. In terms of global mine output, Japan represents 19% of platinum and 21% of palladium consumption.
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- Nearly 50% of the annual global production of palladium is used in catalytic converters in automobiles. More than half of the domestic demand for palladium in Japan is from the auto sector.
- The second largest industrial use of

Alternatives such as the Chinese auto sector and crude oil prices could explicate possible future impacts in the market. An estimated 11% growth in auto sales in China in 2012 by the The China Association of Automobile Manufactures (following a disappointing year in 2011 where sales went up only by 2.5%) may likely support global palladium demand in the coming months. On the other hand, higher crude oil prices can hinder the rise in palladium price as the inflation potentially from higher crude oil prices may impede auto sales.

Since the auto industry accounts for the largest share of platinum and palladium consumption, growth forecasts for this industry would also affect demand for these metals. The US, China and Europe will likely lead auto demand in the coming years. Let's have a look at some es-

Moving to palladium demand, Japan represents nearly 17% of global demand. A significant portion of the metal is used in autocatalysis, electronics, dentistry and fuel cells. Palladium demand for autocatalysis in Japan was around 0.66 million ounces in 2011. However, Japan's palladium jewelry consumption (0.07 million ounces in 2011) is weak in comparison with platinum ornaments. It is important to note that investment demand for palladium in Japan is almost negligible (Chart 8 and Chart 9).

Let's look at a few more numbers that affirm the role of Japan in platinum and palladium markets (Chart 10).

- Japan's total consumption (including jewelry and industrial) was 1.33 million ounces in 2011 in the case of

Global Palladium Demand By Region, 2006-2011

So ROW China India Japan Europe

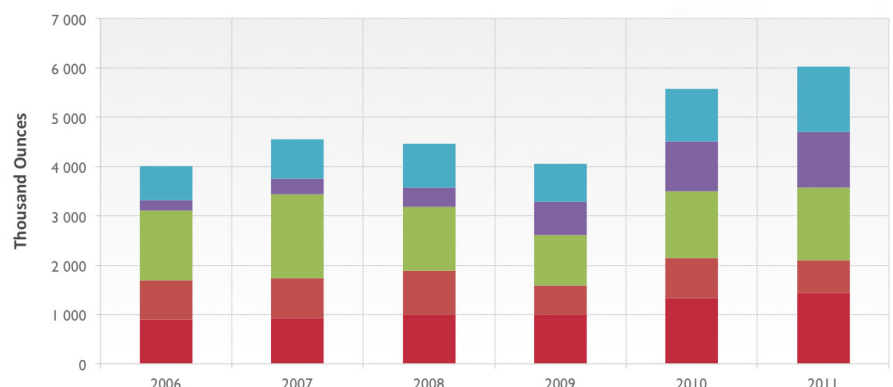


Chart 10: Global Palladium Demand by Region, 2006-2011

timates.

- The National Statistics Institute registered a growth in automobile industry orders in 2011, in continuation of a 24% increase in the automobile industry orders in 4Q10 in comparison with 2009.
- For most of 4Q11 and throughout 2012, Japanese auto sales registered not only growth, but strong growth from previous year levels. Despite the drag from the tsunami, auto sales were only 16% down in 2011 from the previous year. In the first eight months of 2012, the auto sales registered in Japan was already almost 80% of the total sales in 2010 (the pre-tsunami year for comparison). During 2010, American auto sales witnessed a 16% increase. This was followed by a close to 11% increase in 2011. Moreover, trade of pick-ups and cross-over vehicles (these type of vehicles use more platinum and palladium) also experienced high sales.
- China's 2010 annual growth in foreign car imports was up 93.3%, as per the China Association of Automobile Manufacturers. Strong growth continued in 2011 as well.
- The European Union is yet to recover to the pre-recession levels of auto sales, which are expected to be achieved only by 2015, as per [European Automobile Manufacturers' Association](#).

Positive signals from the US and China (also India to an extent, indicated by the latest trends) can outweigh the stagnant sales in Europe. All these data assure higher demand for platinum and palladium in the foreseeable future.

So, What's Next?

The aforementioned factors appear already priced-in and presently the platinum/palladium markets follow precious metals moves. However, the upside of PGM markets appears to be confined in the short-term. Any positive news from the industry could support the PGMs market in the present scenario, irrespective of whether Japanese demand is lower (which is certainly not the case). For instance, news of resumption of operations by Japanese automakers encouraged the prices in the second half of 2011. Moreover, a strong growth rate from China and other BRIC nations will likely support healthy demand from Japan.

We have talked about BRIC's influence in

platinum and palladium market in one of our previous essays [Big Gains are to be Made in Platinum and Palladium](#).

"One of the key developments for the platinum group metals over the past few years has been China's rise to dominance as the largest auto market. China, along with India and the other BRIC nations (Brazil and Russia) has witnessed robust auto sales despite a drop in the US and Europe during the recession.

Although, the removal of subsidy, rising fuel prices and stricter new registration laws are likely to hit the Chinese auto markets in 2011, China will remain a primary support for automobile manufacturing for the next few years. Another oriental economy touted to have the potential to replicate China's growth story in the auto market is India. Both India and China have registered robust sales numbers while the auto market remained dampened elsewhere in 2009 and progressed by leaps and bounds in 2010. India is home to well over 40 million passenger vehicles – a healthy 26% sales growth was registered in 2009 while the rest of the bigger auto markets were reeling, making India the second fastest growing automobile market globally."

Improving interest from Chinese traders is also a positive sign. Let's have a look at the physical buying activity from China after the fall in prices. After the earthquake, platinum and palladium traded in Hong Kong at a premium of \$2 an ounce over London spot prices. The premium was around \$1.5 before the tsunami. Also, when palladium prices lowered to \$700, the Chinese palladium market witnessed an active participation. Although the volumes were not substantial, physical buying provided a support to the market.

How will this information be helpful for [Gold and Silver Investors](#)?

How can we measure the strength of China relative to Japan in terms of auto industry growth? According to the Platinum 2010 Interim Report, China auto-catalyst markets consumed 0.93 million ounces of palladium where Japan's industrial demand for palladium was approximately 1.37 million ounces in 2010 where auto-catalysts account for nearly half of that - this keeping in mind the downturn due to the tsunami.

Overall, BRICs can support the PGM markets in the near-term, irrespective of the demand destruction from Japan. In terms

of the fundamentals, long-term trend appears bullish. Once the Japanese automakers resume their operations fully, demand for these metals is expected to soar.

Summing up, the impact of the Japanese disaster was more visible in silver, compared to gold. Considering an upper hand in industrial consumption rates, silver is expected to witness more fluctuations in response to the positive developments in Japan in the current scenario. In view of improvements in industrial demand and emergence of the economy, Japan is anticipated to support the long-term prospects of precious metal prices. Moreover, an expected currency earthquake in the middle to long-term could push precious metals sky-high.

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