Auto-Catalysts – An Automaker’s Perspective

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I. PGM Prices
I think we quite often forget what has happened in the market over recent months and years. It is very easy to be caught up in record gold prices and things like that. Clearly PGM prices have recovered quite well from the lows in 2008, but part of that is driven by gold and we all know that and part of it is driven by investor flows, but they do not perform exactly the same. Palladium is outperforming platinum and you might ask why that is. Is it because of today’s fundamentals or is it because of future fundamentals? Is there some reason rather than the gold price and investor flows? I think there is.

II. Fundamentals
I have shamelessly stolen the Johnson Matthey data from May 2010, which shows the balance of the market and 80% of the market is China, Europe and North America for platinum and palladium. The European diesel market is a platinum market, so that is a major issue. In China the platinum market is mostly jewellery, but the automotive market is palladium. In the North American market quite a lot of the palladium is the automotive market.

As an analyst you sit at a desk and see quite a lot of news flow and people react to that news flow and move the price on the basis of that news flow. The question is, does it have any relevance. If I get a story that says Chinese GDP is rising, the platinum price increases and that is just nonsense, but the automotive market is kind of a GDP market, so there I think there is some relevance to the news flow and to what is happening.

It is very easy to get lost in the year-on-year changes in GDP. Some of the changes are enormous, but really what is more interesting is, what is GDP doing. If you look at the IMF figures, most countries are pretty depressing. If you looked at industrial production the picture would be even worse and capital expenditure would be worse again. China and India are clearly doing pretty well.

It was interesting listening to the presentations yesterday morning and people talking about a double-dip recession. I would agree this is not sustainable, but the fact that it is not sustainable does not mean it will not be sustained for quite a period of time. There does not seem to be any great indication of a double dip; there just seems to be an indication of a very slow recovery and that is what is going to be happening in the next year or two. You can see that in Europe and North America particularly. I think it is still very positive news for the automotive industry from a very poor 2008/2009.

III. The Car Market
If you look at the US car market, there were a huge number of unsold vehicles last year and the question is are they still unsold; what does the US car market feel like? People report on the data they can find and this is the data on which everyone reports. They were reporting on last year particularly, but no-one is reporting on it now, because it is boring. Last year there
was huge unsold inventory in the US clearly reducing very quickly and that is what hit the metal demand, so, although sales may have been pretty disastrous, production underperformed sales by a very long way.

Now we have got back to a more normal level; we have rebuilt inventory a bit and that is positive for the PGMs; it has brought out some demand. I think there is more inventory to be rebuilt in terms of cars, in terms of catalysts and in terms of metal, so there are going to be more inventory changes as well, but it is generally positive.

The fact that we are still decreasing inventory probably means that the car companies do not have the confidence in the market. They are selling a reasonable number of cars, but they are not producing as many as they can sell. That suggests that one of the things in the market now and is not noticed very much is that the forward markets are not as busy as they should be; we should be doing more forward business. If they had confidence, they would be doing that. At the moment I think they are certainly not doing as much as they would like to or would normally do. That feels bullish for both metals in the sense that, when that comes back, that is going to create buying pressure, which will in turn put upward pressure on the price.

IV. The Light Duty Vehicle Market

Sales were not at record levels in 2007, but it was pretty good; sales fell to October 2008 and we have recovered a bit since then. If anyone says the market is not recovering, they are wrong; it is recovering, but if you compare year on year, you are comparing against the government incentives for the previous August and the ‘cash for clunkers’ scheme. Quite frankly it is not a surprise; if you take a subsidy away, you have a year-on-year drop, but clearly the trend is upwards.

We are seeing maybe 11.5 million vehicles produced this year, maybe 12 million with a little bit of luck compared to 15 million in the good days a few years ago. We are seeing recovery, but it is a slow recovery. This is positive for the price of all the metals, but it ought to be more positive for palladium. Bear in mind that the US is essentially a gasoline market and gasoline cars are essentially fitted with palladium/rhodium catalysts.

One question you get from every investor is, at what price do the car companies change and use platinum. The answer is a lot higher than it is today, so that is positive for palladium and probably pretty irrelevant to platinum. If you look at the heavy duty vehicle market, that has relevance to platinum, but light duty vehicles are a palladium story. I get a bit bemused when I see the heavy metals moving in tandem to stories about American car sales.

V. The Heavy Duty Market

The US used to be a very heavily truck-based market, but essentially high gasoline prices, low finance availability and people’s economic worries really hit that market heavily, so you went down to only 40% of the market being trucks rather than 50% a year-and-a-half earlier. I think that was also distorted by things like the ‘cash for clunkers’ scheme. Clearly, if you get a $2,000 subsidy, it is rather more interesting if you are buying a $10,000 car than a $100,000 truck. I think at the moment we are seeing the distortion fade from the market, coming back to something like normality, although I do not think we are there yet.

Trucks are bigger than cars; they have bigger engines; generally they have bigger catalysts as a result and therefore they need more palladium. For palladium this quite a nice upward trend and I think it does begin to explain some of the over performance of palladium compared to platinum.
VI. The Diesel Market

The US is not a diesel market for cars; diesel only account for about 2% of the car market. There is a heavy duty diesel market, which is recovering and that is positive for platinum. It is, however, recovering slowly; it is a more capital-intensive business and people are simply not renewing fleets, if they can avoid that, so there is a story for platinum there. We are really talking about Europe, where about 50% of the market is diesel compared to China where it might be about 3-4%; Russia where it might be 1-2% and North America where it is 1-2%. Diesel is a European story.

Historically it was always a platinum story. That is not quite true now. Diesel cars tend to be more expensive than gasoline cars. Clearly production in the European market is pretty weak; certainly production for European consumption is pretty weak. There are some reasonably successful export sales – the larger German vehicles, but they are palladium rich.

The diesel market is not very good, but it has been recovering and returning to something more like normality. The diesel market dropped to something like 45% of the market; now it back to perhaps 52%. This is positive for platinum. The European market in general is underperforming and likely to underperform next year, but diesel might get a bit more market share.

VII. Emissions Legislation

The sort of thing people forget, because it is boring and they have heard it so many times, is that new European emissions legislation came in last year and comes in again this year for all new vehicles. That means people will have to fit filters, which contain platinum, so again this is a good story for platinum. These filters also increasingly contain palladium and palladium is taking a little bit of market share. This is not for cost effectiveness, because palladium is not cheap; it is because it is good at what it does and what it adds to the mix, so there is a little bit of positivity for palladium as well; good news for both platinum and palladium in the European market, despite a pretty horrible year for sales and production.

VIII. The Chinese Market

Can China keep growing? We heard yesterday about the sustainability of the market. I think there is no doubt it is not sustainable and is not built on real foundations, but I do not think there is any doubt that China is going to keep on growing. This year it will grow 9-10% and it will do the same next year. It is interesting that all the attempts to moderate the market fail. For example, the government took away the subsidy for 1.6 litre and below vehicles at the start of the year to stop the market overheating. About two weeks later they introduced a subsidy for vehicles under 1.6 litres, so as soon as the market moderates, they are unhappy about it and they start subsidising again.

I think you are likely to see that continue, because they want a lot of production and consumption. Clearly they have other issues, but they want to see this for another year or two years, probably longer than that.

To put that into context, US vehicle production this year should be about 11-12 million vehicles. China will be higher than that at possibly 17 million vehicles or even higher. For 2014 you hear government noises about 31 million vehicles produced in China. They are not small vehicles; they are not as big as the US vehicles, but they are normal, European-sized vehicles and they are all gasoline, so again a palladium story. That is the other reason why you see this over performance of palladium compared to platinum.
IX. Rhodium

For anyone who is interested in rhodium, it is also a rhodium story. Rhodium demand is clearly rising because of this. There is a question about whether today’s rhodium price is cheap or expensive and depending on the answer the car makers will either use as much as they can or thrift the metal out to reduce the metal loadings. My feeling is they will probably use more, but cautiously, because they still remember where the prices went.

X. Conclusion

A couple of people I have spoken to have been tremendously depressed about the world. The first presentation yesterday was quite pessimistic about the market and the state of the world as a whole, but actually we are back at 2007 levels in the automotive market and 2007 was a record year. Global vehicle production this year will be 70 million, despite the fact that economies have not recovered. I think the fundamentals in this market are not that bad at all.