Commodities: vulnerable to China and US dollar

We expect that, over the course of the year, the prices of the main commodities will be characterised by high volatility and will remain very vulnerable to dynamics linked to China and the US dollar. Oil remains worthy of special observation, since crude prices' stabilization is a necessary condition to allow the entire sector to be once again driven by the fundamentals of supply and demand, which determine the physical market balance.

Oil: no agreement

Talks about an agreement between some OPEC and non-OPEC producers to freeze production failed, and the markets' attention has moved to the fundamentals of supply and demand, which are improving, and global stocks, which are forecast to rise at an increasingly lower rate.

Metals: downward pressure on gold, upward pressure on industrial metals

After the marked rise recorded since the start of the year, we anticipate that the downward pressure on gold will return, considering the expectations of a more restrictive US monetary policy and the lack of significant inflationary pressure. Conversely, we expect that the fundamentals of supply and demand for industrial metals will become tighter overall over the coming quarters. Consequently, once the fears of an excessive slowdown in the Chinese economy have abated and concerns of a new collapse in oil prices have eased, we forecast an overall stabilisation in the sector, with a sideways trading phase during the summer months and moderate upward pressure on prices before the end of the year.

Agricultural commodities: volatility linked to meteorological risks, but wide stocks

The fundamentals of supply and demand for the main cereals remain extremely weak, as shown by the ample ending stocks, but an improvement is forecast. In the short term, the volatility in the sector will be heightened by the uncertainty regarding the meteorological conditions in South America and United States.

April 2016

Quarterly Outlook

Intesa Sanpaolo
Research Department

Macroeconomic and
Fixed Income Research

Daniela Corsini, CFA
Economist – Commodities

Prepared on the basis of the information available as at 28.04.2016

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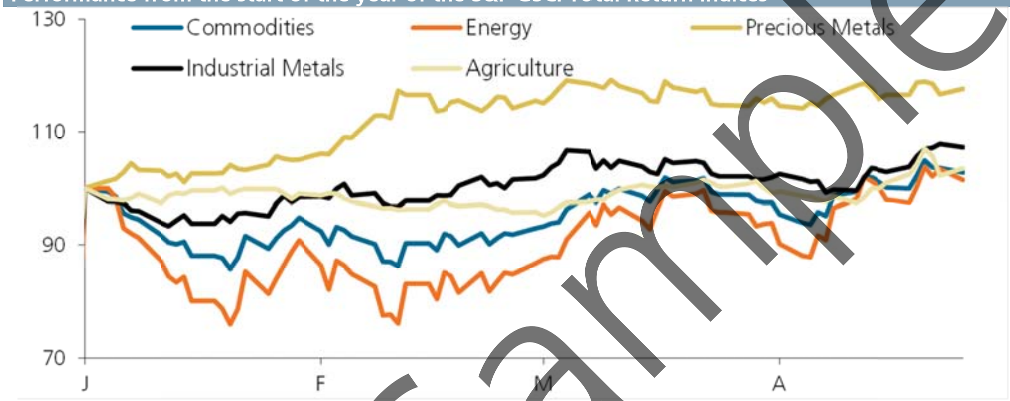
At the time of writing, the main commodities indices are trading at levels close to those recorded at the start of the year, with the exception of precious metals. In particular, the energy sector recovered most of the losses cumulated during January and February, thanks to the first signs of a drop in non-OPEC supply and speculation concerning possible freezing of the output levels by the main producers.

Precious metals over-performed dramatically, thanks to the weakness of the US dollar and of the macroeconomic data from the 1st quarter of the year.

Performance from the start of the year of the S&P GSCI Total Return indices

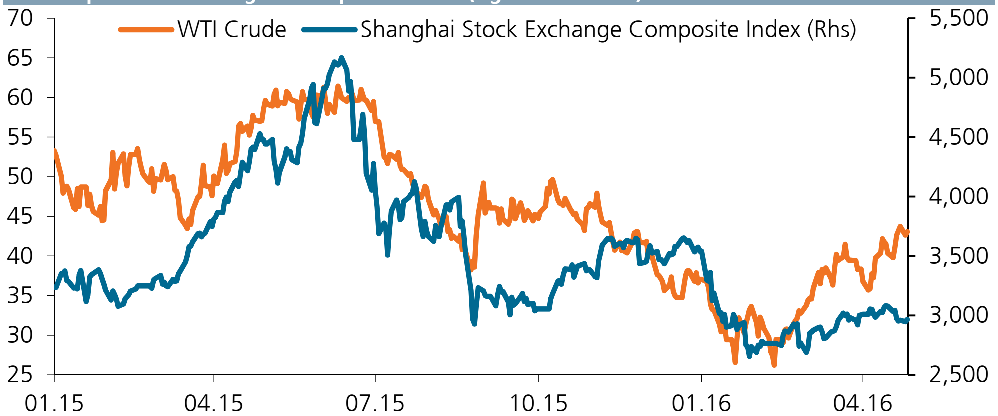


Source: Intesa Sanpaolo chart from Bloomberg data

We see as a positive sign the fact that the performance of the main commodities during these first few months of 2016 has been consistent with expectations linked to the fundamentals of supply and demand. Thus, markets have not been driven by purely speculative dynamics.

However, in our opinion the sector is still extremely vulnerable to financial variables, such as the level of liquidity in the system, currency trends, fluctuations in market sentiment between risk aversion/appetite or stock market trends. In particular, the last few quarters have shown how considerable drops on the Chinese stock market have direct repercussions on the prices of energy and industrial commodities, through their impact on risk aversion, investor confidence and portfolio liquidity.

WTI oil prices and Shanghai Composite index (right-hand scale)



Source: Intesa Sanpaolo chart from Bloomberg data

In our view, future trends in commodities prices over the next few months will also remain strictly linked to China, the world's largest consumer. Consequently, all the macroeconomic variables used to monitor the health of the Asian giant and to assess the progress of the reforms undertaken by the government will also be considered relevant for obtaining indications about the commodities markets. In particular, the most important subjects to consider remain: economic growth, the liberalisation of the financial markets and the performance of the domestic stock market.

Moreover, commodity trading in China rose dramatically in April, causing concern to the main exchanges: the Shanghai Futures Exchange increased transaction fees; the Dalian Commodity Exchange raised iron margin requirements and tightened rules on what it calls "abnormal trading" and the Zhengzhou Commodity Exchange urged greater prudence on cotton transactions amid "relatively large price fluctuations". The interest for commodities has been driven both by the significant rise in liquidity on the domestic market, amid worsening prospects for investment in equities and bonds, and by the recovery in demand for commodities. In addition, Chinese investors have been attracted by the possibility of leveraged purchases on these exchanges and by the good performances recorded since the start of the year by some specific products.

In our view, Chinese financial market trends on commodity trading will need to be carefully monitored, since the pressures on domestic prices are easily transferred to international prices. Indeed, speculative flows could quickly change direction and high levels of leverage could amplify any sell-off, as happened on the equity market crash in 2015.

Our forecasts for the commodities universe

Overall, we expect high volatility in the global commodities sector, heightened by the attention (and nervousness) with which the markets are monitoring:

- the publication of the main macroeconomic indicators (especially in China, United States and Eurozone);
- changes in the relative strength of the US dollar, linked to changes in the monetary policy of the Federal Reserve and developments in the US presidential campaign;
- the publication of data and estimates concerning the physical markets of individual commodities;

- declarations and comments from policy makers and international agencies concerning commercial policies or future market scenarios.

Moreover, based on our macroeconomic scenario and the analysis of supply and demand fundamentals, we expect that commodities prices will remain low for a long period. Indeed, supply remains abundant overall, while demand missed expectations over the last few quarters, amid a persistently fragile economic growth characterizing the main emerging markets.

At the moment, we believe that especially crude oil will remain extremely vulnerable to downside risks, since global demand estimates could be cut once again if economic growth remains weak in China and Latin America and if the removal of part of the generous subsidies which Middle Eastern consumers have enjoyed for several years leads to lower domestic consumption. Our baseline scenario confirms an ongoing oversupply, despite the significant drop in non-OPEC production estimated for 2016. It is only in 2017 that we expect the markets to become balanced once again. Over the next few months, various external factors could increase short-term volatility, such as speculation regarding changes in the geopolitical equilibrium and the implementation of agreements between producers about the future level of production.

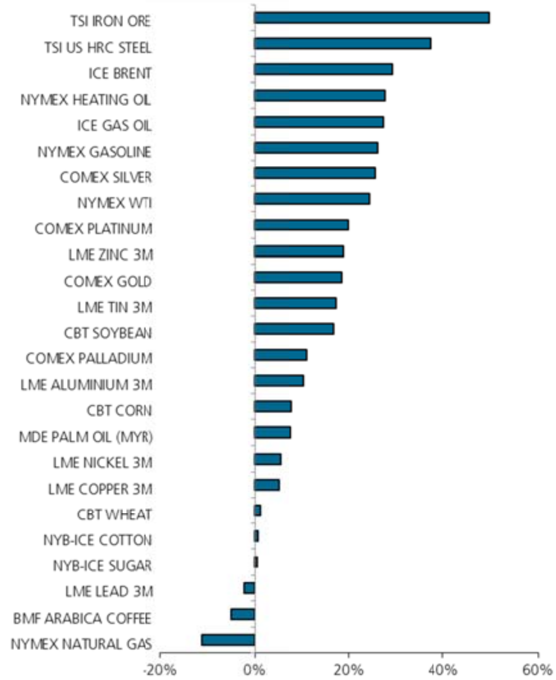
As regards precious metals, the good performances recorded since the start of the year can be explained through risk aversion, demand for safe-haven assets, uncertainty about the evolution of US interest rates and about the resulting weakening of the US dollar. In view of our forecast pointing toward an improvement in the flow of US macroeconomic data and a gradual raise of rates by the Fed, we feel that the space for further rallies in gold and silver prices is limited and we expect a moderate retracement by the end of the year.

The industrial metals markets will be guided, above all, by China. As a result, it will be necessary to monitor both the trend in macroeconomic data regarding domestic market and foreign trade conditions, and announcements of new stimulus measures from Central Bank and government. The main source of uncertainty which affects our scenario is represented by speculation on the Chinese exchanges, which, if not adequately controlled, could cause a new bubble and a subsequent sell-off.

As regards the fundamentals for many metals, the heavy contraction in investments by mining companies over the last few years could finally lead to tighter markets and a noticeable improvement in supply and demand fundamentals. However, prices will only reflect this positive trend if fears of a Chinese slowdown abate and if there is a stabilisation in the oil price, the collapse of which increases the risk aversion, penalising the main energy and industrial commodities. In our baseline scenario, we forecast an overall stabilisation in the industrial metals sector, with the start of a sideways trading phase. On one hand, significant reductions will be limited by the improving fundamentals. On the other hand, upward pressure will be kept in check by the overall fragility of global growth and by recurring fears concerning the Chinese economy.

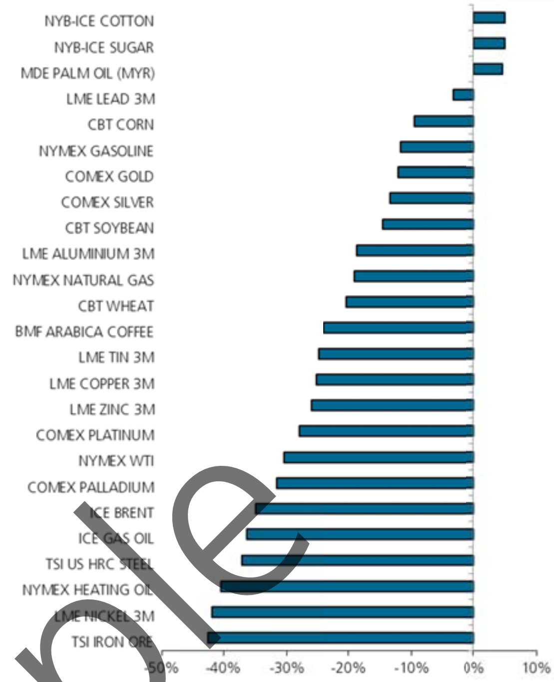
The supply and demand fundamentals for the main cereals remain extremely weak, as shown by the ample ending stocks, but an improvement is forecast. We expect that the volatility in the sector will be heightened by the uncertainty regarding the meteorological conditions, since the El Niño phenomenon should come to an end over the next few months and it may be replaced by the La Niña phenomenon, which often alters climate patterns across vast areas.

Performance from the start of the year until 28.04.16



Source: Intesa Sanpaolo chart from Bloomberg data

2015 performance



Source: Intesa Sanpaolo chart from Bloomberg data

Oil: no agreement

Talks about an agreement between some OPEC and non-OPEC producers to freeze production failed, and the markets' attention has moved to the fundamentals of supply and demand, which are improving, and global stocks, which are forecast to rise at an increasingly lower rate.

Supply and demand fundamentals

At the time of writing, oil is close to its highest levels since the start of the year, as a result of the optimism with which the markets have greeted the first signs of improvement in the fundamentals. The long-awaited rebalancing is finally in progress, as the US production is declining and demand is expected to rise significantly.

Nevertheless, in our view it is still too early not to exercise caution. Indeed, the latest data available in mid-April and published in the monthly reports of the Organization of the Petroleum Exporting Countries (OPEC), the International Energy Agency (IEA) and the US Energy Information Administration (EIA) once again painted a picture of oversupply and growing stocks, albeit at a lower rate, for several quarters. Depending upon the agency considered, market balance is expected to be reached at the end of 2016 or the end of 2017.

For example, according to the EIA, the current pace of inventory builds, useful for assessing the supply surplus, should settle on average at around 1.4 mb/d in 2016, then fall significantly to around 0.4 mb/d in 2017. However, any talk of balanced markets will have to wait until the second half of 2017 and stock reduction, a sign of tight markets, is beyond the forecast horizon.

Currently, the three main forecasters predict that consumption may grow by 1.2 mb/d this year and settle at an average of around 94.9 mb/d for the whole of 2016, and the EIA, the only agency to publish estimates for 2017, believes that demand may grow by a further 1.3 mb/d over the next year.

Non-OPEC supply is expected to fall from 2016 onwards, the first drop since 2008. Production is estimated at an average of 56.9 mb/d for 2016, a fall of 0.6 mb/d compared with 2015, and should decline by a further 0.5 mb/d in 2017, according to the EIA. In both years, the greatest contraction should be in the supply of US crude, since the production of shale oil is characterised by greater flexibility in the development of extraction projects and rapidly decreasing yields.

In view of the expectations of rising global demand and falling non-OPEC supply, in 2016 and 2017 the call on OPEC crude, i.e. the quantity of oil which the members of the group must supply to balance the markets, is forecast at an average of 31.4 mb/d in 2016, a rise of 1.6 mb/d compared with 2015, and should reach 32.3 mb/d in 2017, according to the EIA, a further increase of 1.5 mb/d.

Supply and demand as estimated by OPEC, the IEA and the EIA for the year 2016

Estimates published in April 2016, in million barrels per day	Total Demand	Non-OPEC Supply	OPEC LNG Supply	*Call on OPEC crude*
OPEC	94.2	56.4	6.3	31.5
vs. 2015	1.2	-0.7	0.2	1.8
IEA	95.6	57.0	6.8	31.8
vs. 2015	1.2	-0.7	0.2	1.6
EIA	94.9	57.2	6.9	30.8
vs. 2015	1.2	-0.4	0.3	1.3

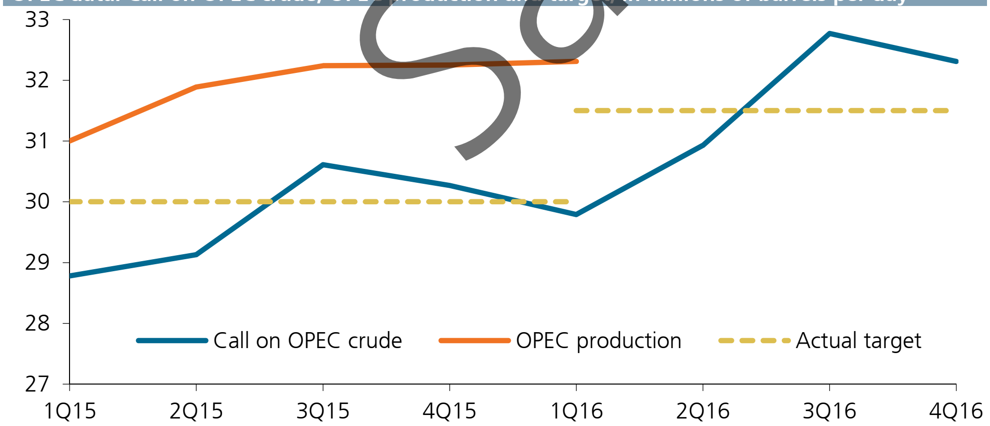
Source: Intesa Sanpaolo chart from data published by OPEC, the US EIA and the IEA

Supply and demand as estimated by the EIA for the year 2017

Estimates published in April 2016, in million barrels per day	Total Demand	Non-OPEC Supply	OPEC LNG Supply	*Call on OPEC crude*
EIA	96.2	56.7	7.2	32.3
vs. 2016	1.3	-0.5	0.3	1.5

Source: Intesa Sanpaolo chart from data published by OPEC, the US EIA and the IEA

OPEC data: Call on OPEC crude, OPEC production and target, in millions of barrels per day



Source: Intesa Sanpaolo chart from OPEC data

In view of these estimates of demand, supply and global stocks, we can exclude the hypotheses of a coordinated cut in production by OPEC members and an agreement with other producers outside the Group to reduce global supply. Indeed, the chief beneficiaries of such measures would be producers outside the Group, who would quickly regain market share. In addition, evaluating the current environment from a purely political perspective, coordination within OPEC remains extremely difficult, given the Iranian desire to increase export volumes and recover market shares after years of harsh sanctions and the widespread deterioration of public finances triggered by the collapse in crude prices, which affected all OPEC producers.

Consequently, crude prices will remain low for a long time yet; this is a painful condition for the producers, but necessary for rebalancing the market. The low prices should boost growth in global demand, slow down the ongoing energy saving and replacement processes, and will reduce supply from producers with the greatest marginal production costs, resulting in a slow, yet steady erosion of the supply surplus.

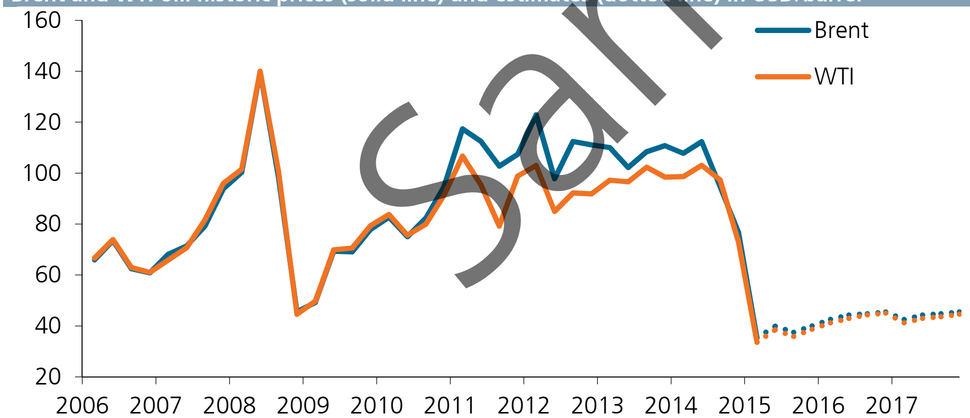
Forecasts

We expect that the next few months will be characterised by high volatility. The overall fragility of the fundamentals still justifies the forecast of persistently weak prices, which will continue for some time due to the slowness of the ongoing process to reduce non-OPEC supply.

In our opinion, the market's reading of data indicating the start of the current rebalancing process was overly optimistic and we thus expect a price correction over the next few months. We expect that Brent and WTI will trade below the level of USD 40 between the end of Q2 and the start of Q3 before recovering slightly to an average of around USD 40.0 for Brent and USD 38.7 for WTI in the final quarter of 2016.

Over the next two years, the supply and demand fundamentals should become tighter, thus generating a slight recovery in prices, but we believe that balanced markets will not be reached until the second half of 2017. In general, our current expectations are that prices will not stabilise above USD 50 until the market is once again balanced. Indeed, this level would encourage investments, especially in shale oil, justifying an upward revision of non-OPEC supply estimates. In the absence of a particularly brilliant growth in demand, this would indicate a further slowdown in the lengthy process of rebalancing the markets.

Brent and WTI oil: historic prices (solid line) and estimates (dotted line) in USD/barrel



Source: Intesa Sanpaolo estimates. Compiled by Intesa Sanpaolo from Bloomberg data

Price estimates for Brent

As of 25.04.2016	2Q16	3Q16	4Q16	1Q17	2016	2017	2018
Estimates	39.9	37.5	40.0	42.6	38.2	44.3	49.2
Bloomberg Median	39.0	43.5	46.5	47.2	41.0	55.0	63.0
Forward Contracts	44.5	46.2	46.7	47.4	43.6	48.3	50.6

Source: Intesa Sanpaolo chart from Bloomberg data

Price estimates for WTI oil

As of 25.04.2016	2Q16	3Q16	4Q16	1Q17	2016	2017	2018
Estimates	38.5	35.9	38.7	41.2	36.7	43.4	48.7
Bloomberg Median	38.0	42.5	46.0	46.2	40.0	53.0	60.0
Forward Contracts	42.0	45.3	45.7	46.3	41.8	47.0	48.6

Source: Intesa Sanpaolo chart from Bloomberg data

Metals: downward pressure on gold, upward pressure on industrial metals

After the marked rise recorded since the start of the year, we anticipate that the downward pressure on gold will return, considering the expectations of a more restrictive US monetary policy and the lack of significant inflationary pressure. Conversely, we expect that the fundamentals of supply and demand for industrial metals will become tighter overall over the coming quarters. Consequently, once the fears of an excessive slowdown in the Chinese economy have abated and concerns of a new collapse in oil prices have eased, we forecast an overall stabilisation in the sector, with a sideways trading phase during the summer months and moderate upward pressure on prices before the end of the year.

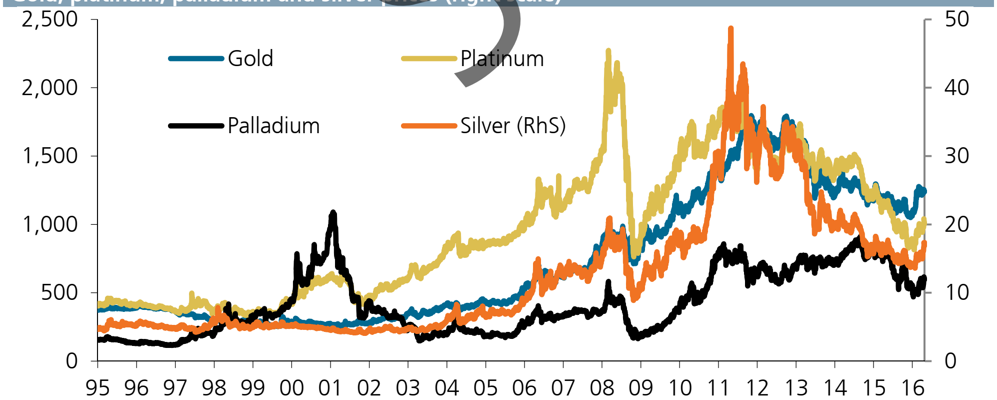
Precious metals

From the start of the year until mid-April, gold recorded the best performance among the main precious metals, dragging the entire sector upwards thanks to various factors, including the frequent revisions of forecasts about the evolution in US rates and the resulting weakening of the US dollar, risk aversion episodes amid concerns about the strength of the global economic cycle and demand for safe-haven assets.

However, this trend has been reversed since mid-April and the performance of gold has been comfortably exceeded by that of silver, platinum and palladium. We expect this trend to continue for a few more months. Indeed, our forecast of an improvement in the flow of US macroeconomic data and a gradual raise of Fed's rates would be consistent with a moderate retracement of gold prices by the end of the year, whereas more optimistic assessments of the macroeconomic situation in the main Asian economies would enable the other precious metals to regain ground relative to gold, thanks to their wide range of usages in the industrial sector.

However, we would encourage caution about the excessively rapid rallies recorded by certain metals, such as silver. Although the fundamentals have improved, rises as rapid as that recorded in April are mainly driven by momentum trading and could thus end abruptly and be followed by a rapid retracement to more sustainable levels.

Gold, platinum, palladium and silver prices (right scale)

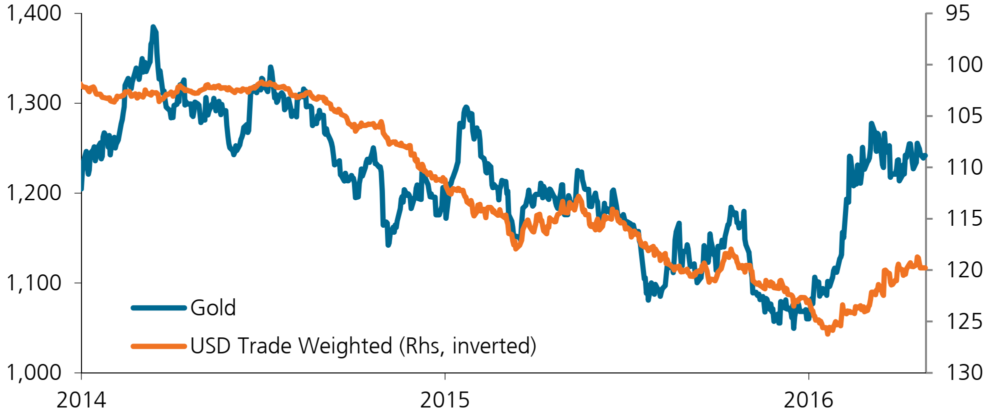


Source: Intesa Sanpaolo chart from Bloomberg data

Gold

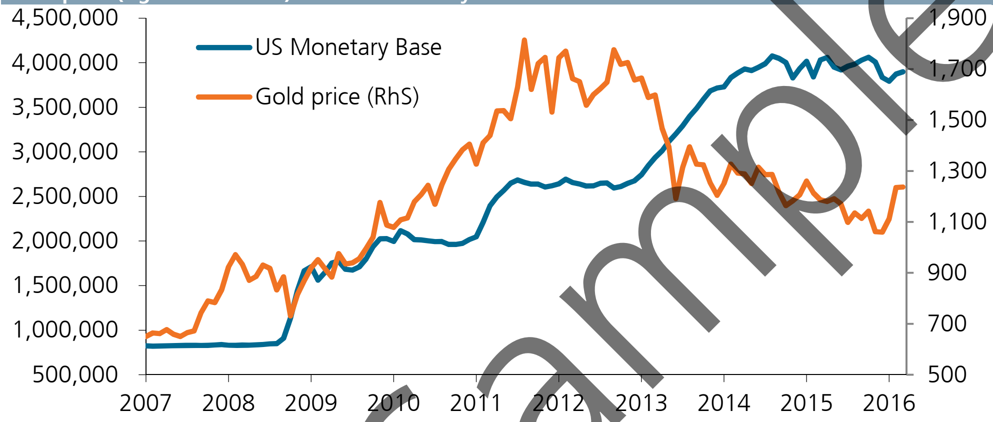
We expect an average gold price of USD 1,200 an ounce for 2Q16 and an average price of USD 1,170 for all of 2016. In our view, the rally recorded by gold since the start of the year is not justified by either the fundamentals or the current macroeconomic scenario. Indeed, according to our analyses, is it not consistent with the moderate weakening of the dollar, nor with the trends expected for the US monetary base.

Gold and the US dollar weighted for trade (right-hand scale, inverted)



Source: Intesa Sanpaolo chart from Bloomberg data

Gold price (right-hand scale) and US monetary base



Source: Intesa Sanpaolo chart from Bloomberg data

We therefore expect that the precious metal will lose ground over the next few months, driven by the expectation of more restrictive US monetary policy. In fact, now that the first quarter's uncertainties have been overcome, we should see confirmed our scenario of a rise in rates, albeit very slow and gradual, entailing a moderate strengthening of the dollar.

Moreover, future upward pressures should be limited by expectations of very low inflation in developed countries, amid an energy scenario of prices close to current levels for some time yet.

Demand for physical gold in the main emerging countries should not surprise upwards, given the current clampdown on corruption in China, which is discouraging purchases of luxury goods, the disappointing monsoon season in India and the collapse in oil revenues in Middle Eastern countries.

Silver

We estimate an average silver price of USD 15.8 an ounce for 2Q16 and an average price of USD 15.8 for all of 2016. Silver is the precious metal which has recorded the best performance since the start of the year, thanks to a favourable combination of risk aversion, and consequent demand for safe-haven assets, and increased optimism regarding the growth prospects for the main Asian economies.

Nevertheless, if, during the first few months of this rise, prices were rightly guided by an improvement in the expected supply and demand fundamentals, the upward momentum which led to the rally in April has been mainly driven by speculative flows and in our opinion silver rose too much and too quickly.

We now expect the current rally to continue up to a maximum of USD 18. Then, we fear that the metal will fall back to a range of USD 15/15.5. In the hypothesis of a much larger than expected sell-off, we see USD 14 as a support level justified by fundamentals.

Our forecast for an annual average of USD 15.8 is based on the expectation that the two central quarters of the year will be characterised by high volatility, but with markets in trading range. Serious downward pressure will be heightened by the negative prospects for investment demand, in view of the fact that more restrictive US monetary policy and the lack of inflationary pressure should discourage investment in precious metals. Conversely, upwards pressure, which is set to intensify, especially during the final few months of the year, should be driven by a rise in industrial consumption and in the jewellery sector, thanks to the expected strengthening of demand in Asia.

Gold-silver ratio

Source: Intesa Sanpaolo chart from Bloomberg data

Platinum and palladium

Despite the collapse in prices recorded in 2015, platinum and palladium are those characterised by the best fundamentals among precious metals. According to our estimates, both markets should record a deficit on the physical market in 2016 and the gap between demand and supply should grow in subsequent years.

In fact, despite a supply which should remain more or less stable relative to 2015, we expect a strong recovery in demand, thanks to expectations of consumption growth in the automotive sector, driven by vehicles sales in Asia.

However, at the moment we expect the deficit to grow more rapidly for palladium than platinum because of the preference for gasoline vehicles in emerging Asian countries, which use catalysts with a higher palladium content.

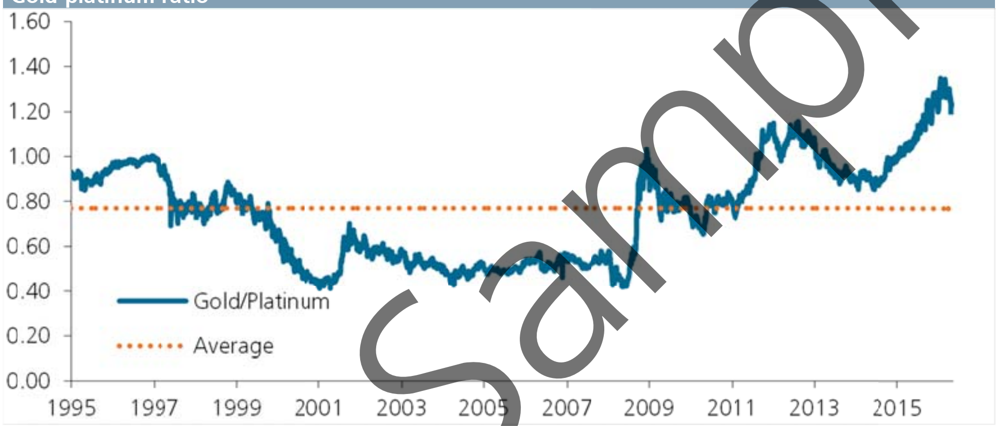
Moreover, the low average prices recorded over the last few quarters have made recycling processes relatively unattractive and we therefore envisage only a slight increase in secondary supply.

We estimate an average platinum price of USD 975 an ounce for 2Q16, and an average price of USD 978 for all of 2016. We estimate an average palladium price of USD 550 an ounce for 2Q16, and an average price of USD 560 for all of 2016. Overall, the rally in April has already brought platinum and palladium close to our end-of-year price targets (1,050 per platinum, 600 for palladium) and we therefore expect a moderate retracement before the end of this quarter and then markets in trading range, rising slightly before the end of the year.

In our opinion, most of the volatility which we will see in platinum and palladium prices will be influenced by movements in the US dollar and by speculative flows, attracted by the stabilisation in metals' prices after the sell-off recorded in 2015. We believe that the main risk weighing on our forecasts for platinum and palladium is a possible depreciation of the South African rand relative to the US dollar. Indeed, if the South African currency were to weaken further, we would see a fall in average production costs in dollars (greater for platinum, since production in South Africa represents a much higher percentage of global supply) and this would erode the support from which prices are currently benefiting.

As regards the gold/platinum ratio, after the peak recorded during the first few months of 2016, we expect a fall to an average level of 1.1, still much higher than its historical average, but indicative of the expected improvement in industrial demand.

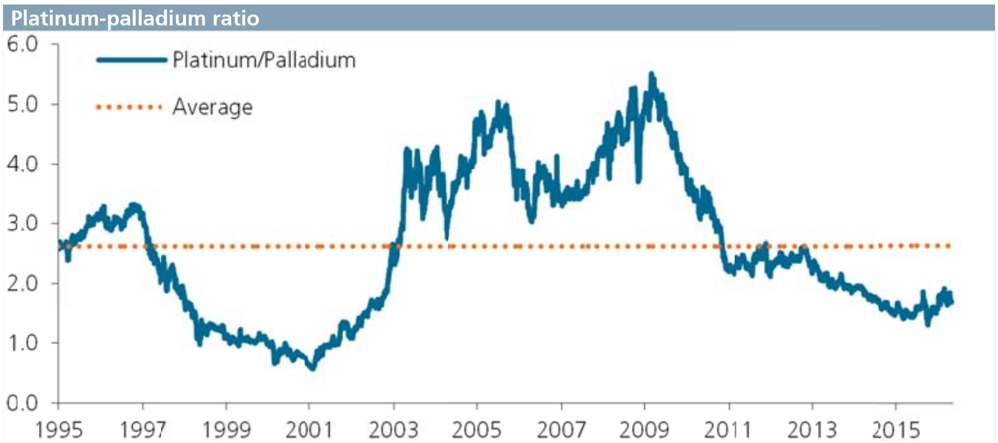
Gold-platinum ratio



Source: Intesa Sanpaolo chart from Bloomberg data

We estimate that the the platinum/palladium ratio will stay close to an average of 1.7 during 2016, lower than its historical average as a result of the expected improvement in fundamentals for palladium; for which we forecast a more rapidly expanding deficit.

Platinum-palladium ratio



Source: Intesa Sanpaolo chart from Bloomberg data

Industrial metals

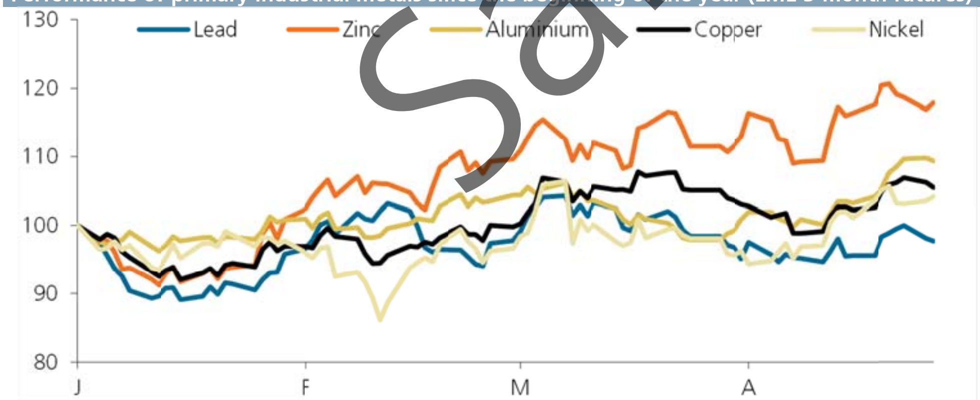
We expect that, over the next few months, the industrial metals markets will be guided by three important issues:

- China. The main source of uncertainty which affects our scenario is represented by speculation on the Chinese exchanges, which, if not adequately controlled, could cause a new bubble and subsequent sell-off. Moreover, in view of the leading role played on the global consumption of commodities (and also on global supply, for certain metals), an in-depth analysis of the quality and strength of the Asian giant's economic growth remains essential. As a result, it will be necessary to monitor both the trend in the most important macroeconomic data, and announcements of new stimulus measures from the Central Bank and government.
- Fundamentals improving, thanks to the heavy contraction in investments by mining companies over the last few years;
- US dollar. A considerable strengthening of the US currency would discourage investments in commodities and fuelled downwards pressure on the sector.

Our current baseline scenario forecasts that, once the fears of an excessive slowdown in the Chinese economy have abated and fears of a new collapse in oil prices (which would increase risk aversion once again, damaging the entire commodities sector, excluding precious metals), have eased, the prices of the main industrial metals may begin to stabilise overall, experiencing a sideways trading phases during the summer months and suffering moderate upwards pressure on prices before the end of the year.

3-month futures quoted on the LME for copper, aluminium, nickel, zinc and lead are used as benchmarks for price forecasts and targets.

Performance of primary industrial metals since the beginning of the year (LME 3-month futures)



Source: Intesa Sanpaolo chart from Bloomberg data

Copper

In our baseline scenario, we estimate an average copper price of USD 4,764 per tonne for 2Q16, and an average price of USD 4,810 for all of 2016. We therefore expect that this metal may have already reached its lowest levels this year and that prices are currently stabilising, amid the expected improvement in the macroeconomic scenario and easing concerns about a slowdown of the Chinese economy and a strengthening US dollar.

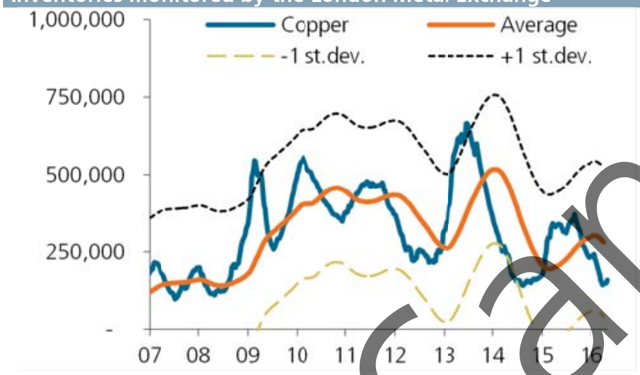
In addition, the fundamentals of supply and demand have also improved and we are seeing the first signs of a more balanced market thanks to the lack of investment in new mining capacity over the last few years outside of China. Secondary supply from recycling should also suffer a slowdown, discouraged by low prices.

According to the latest estimates made during the semi-annual meeting of the International Copper Study Group (ICSG) in March, the global market for refined copper is expected to remain more or less balanced over the next two years: the forecast is for a very slight deficit of 56 thousand tonnes in 2016 and a surplus of barely 20 thousand tonnes in 2017.

The signals coming from the stocks at the LME are apparently very positive, considering the sharp fall which began in 2015. However, in our view, this trend is not so much linked to an actual acceleration in demand, as confirmed by a more or less stable stock-to-consumption ratio, but rather to a relocation of metal toward warehouses in Asia, as can be seen from the substantial rise in stocks at the Shanghai exchange.

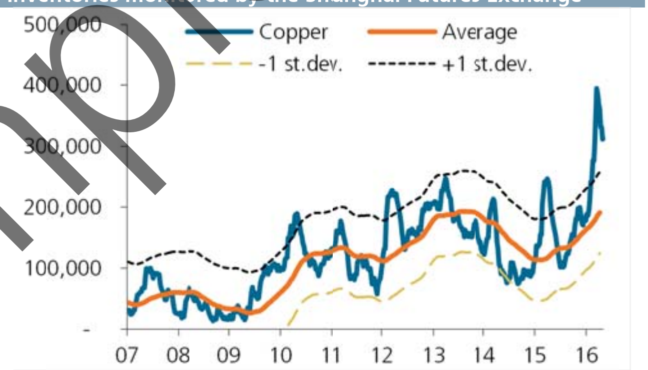
Among the main downside risks weighing on our scenario, we note that demand in China could again miss expectations. In addition, new disappointing macroeconomic data in the major economies could exert negative pressures on copper prices, the metal historically most vulnerable to the health of the global economic cycle.

Inventories monitored by the London Metal Exchange



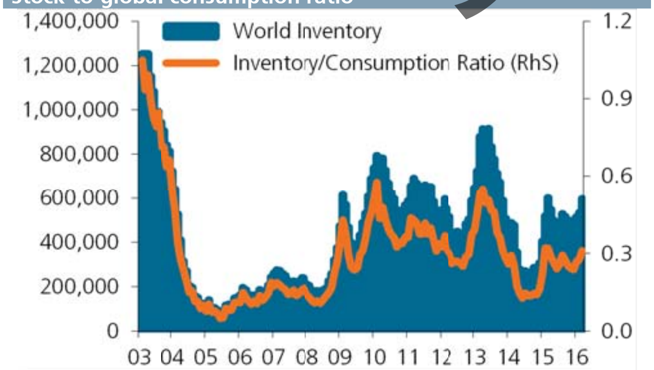
Source: Intesa Sanpaolo chart from Bloomberg data

Inventories monitored by the Shanghai Futures Exchange



Source: Intesa Sanpaolo chart from Bloomberg data

Stock-to-global consumption ratio



Source: Intesa Sanpaolo chart from LME, WBMS data

Prices of the 3-month futures on the LME

Source: Intesa Sanpaolo chart from LME data

Aluminium

We estimate an average aluminium price of USD 1,500 a tonne in 2Q16 and an average price of USD 1,520 a tonne in all of 2016. Overall, we expect that aluminium will spend most of the next few months within a trading range of between USD 1,500 and USD 1,600. It is our view that this relatively narrow trading range is justified by both the stabilisation expected in energy input prices, the main component of aluminium production costs, which will sustain the final prices of the metal, and by considerable oversupply in China, which will prevent prolonged rises.

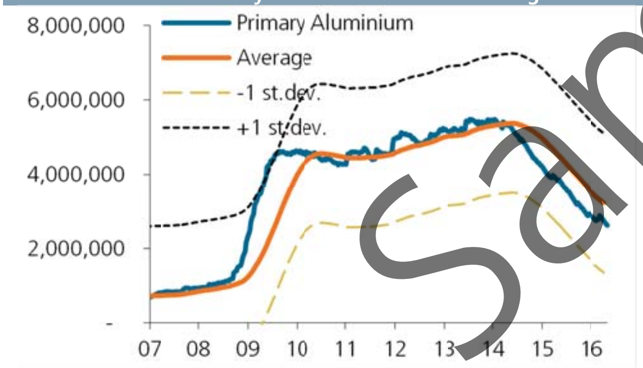
Indeed, the abundant Chinese production will continue to increase the surplus on the domestic market and promote high volumes of exports to the rest of the world, which is suffering an apparent deficit.

As with copper, the ongoing fall in aluminium stocks at the LME is not indicative of a genuinely tight market, but reflects a relocation toward private warehouses in Asia. In particular, this trend is fuelled by the introduction of stricter regulations at the LME warehouses to prevent the creation of long delivery queues and by the lower economic convenience of inventory financing deals, which had previously benefited from low US interest rates.

We think that the main risk element for our scenario is the uncertainty regarding developments in the aluminium sector in China. On one hand, the government should further increase its official primary aluminium reserves, sustaining domestic demand and prices, in an attempt to help local producers in difficulty, prevent closures and protect employment in the sector. On the other hand, rising prices since the start of the year and assistance from the government should continue to encourage domestic production, fuelling oversupply and therefore exports.

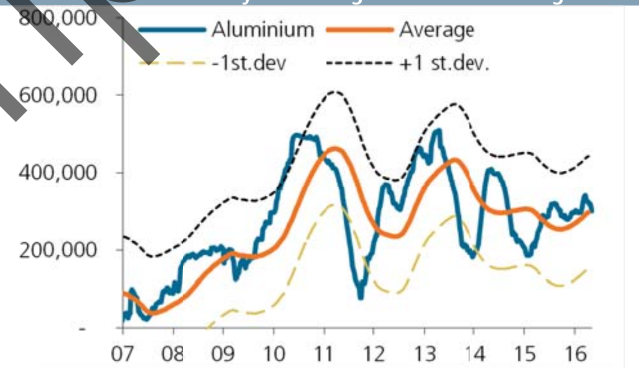
Over the next few months, changes to the market balance on the domestic market in China will be the most important variable influencing international prices.

Inventories monitored by the London Metal Exchange



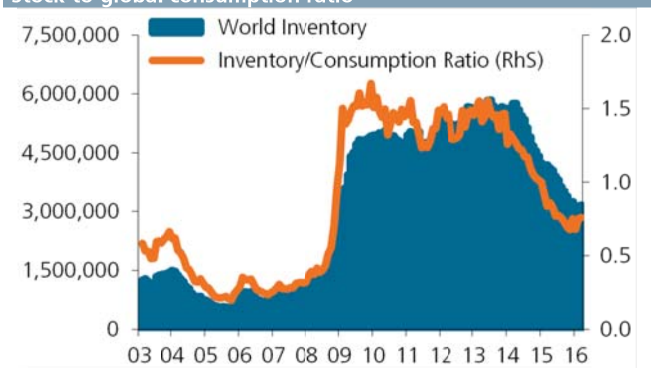
Source: Intesa Sanpaolo chart from Bloomberg data

Inventories monitored by the Shanghai Futures Exchange



Source: Intesa Sanpaolo chart from Bloomberg data

Stock-to-global consumption ratio



Source: Intesa Sanpaolo chart from LME, WBMS data

Prices of the 3-month futures on the LME

Source: Intesa Sanpaolo chart from LME data

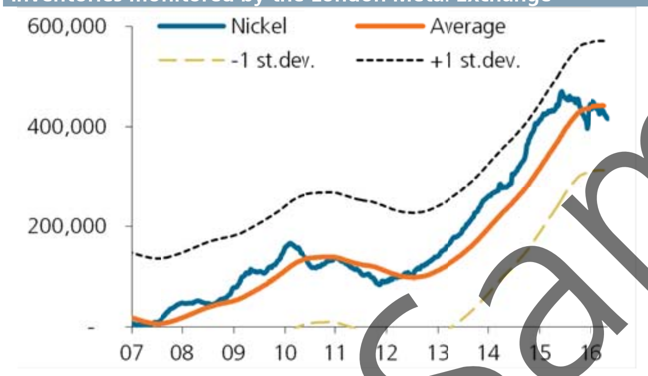
Nickel

We foresee an average refined nickel price of USD 8,650 a tonne in 2Q16 and an average price of USD 8,810 in all of 2016. Despite the marked improvement in the fundamentals of supply and demand and the expectation of a market which will finally experience a deficit in 2016, we believe that nickel will fail to steadily trade above the level of USD 10,000 because of the downward pressure exercised by the high stocks.

The latest estimates published by the International Nickel Study Group (INSG) confirm the stronger fundamentals and indicate that the market will once again experience a deficit in 2016 after four years of surplus. In fact, output should fall to 1.913 million tonnes in 2016 from 1.983 million in 2015 thanks to the cuts in production implemented over the last few years. Consumption should rise to 1.962 million tonnes from 1.89 million in 2015, thanks to the current positive trends in the aerospace industry and the battery sector. In addition, according to the INSG, the production of nickel pig iron in China should fall further thanks to reduced availability of high-grade nickel laterites imported from the Philippines.

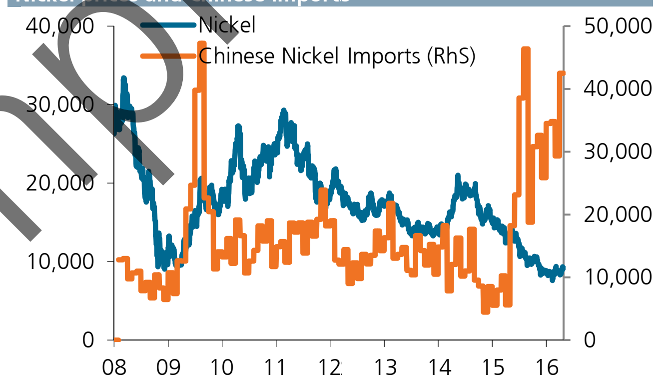
We think that the main risk for nickel is another slowdown in the property sector in China and a worsening macroeconomic scenario in Europe.

Inventories monitored by the London Metal Exchange



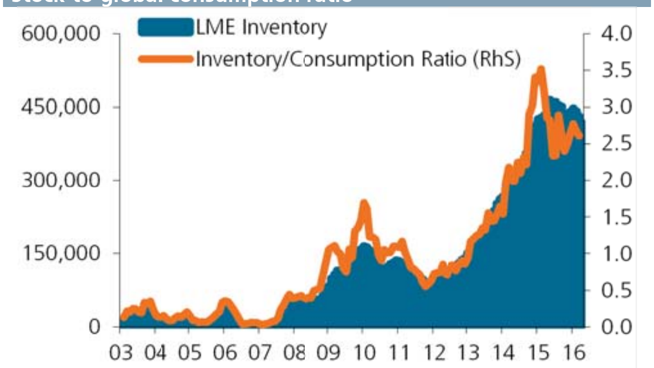
Source: Intesa Sanpaolo chart from Bloomberg data

Nickel prices and Chinese imports



Source: Intesa Sanpaolo chart from Bloomberg data

Stock-to-global consumption ratio



Source: Intesa Sanpaolo chart from LME, WBMS data

Prices of the 3-month futures on the LME

Source: Intesa Sanpaolo chart from LME data

Zinc

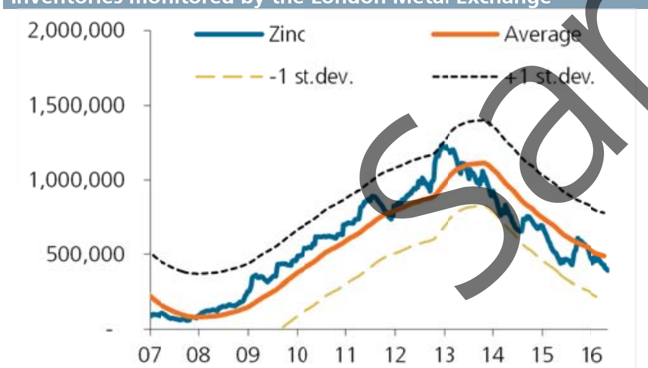
In our scenario, **we estimate an average refined zinc price of USD 1,800 a tonne for 2Q16 and an average price of USD 1,817 for the whole of 2016.** Zinc is the metal characterised by the best fundamentals. In fact, we forecast a rapidly expanding deficit in 2016 caused by the cuts in supply implemented over the last few years outside of China and growing global consumption in China and United States. However, the rally recorded since the start of the year was so strong that the metal hit our end-of-year target of USD 1,900. Consequently, our price forecasts are relatively conservative for the next few quarters since we believe that the movement since the start of the year has been too fast and we fear that the metal is now vulnerable to profit taking.

Moreover, despite the fact that the fundamentals are particularly brilliant, zinc remains particularly vulnerable to fears of a slowdown in China and United States. In particular, concerns about a future drop in the production of Chinese steel could bring downward pressure on zinc prices.

According to the latest data published at the end of April by the International Lead and Zinc Study Group (ILZSG), the market should experience a deficit in supply of around 352,000 tonnes in 2016. Global demand for refined zinc should rise by 3.5% yoy, driven by increased consumption in Asia, especially in China (+4.5% yoy), India (+4.1% yoy) and Japan (+4.2% yoy), and in the United States (+3.1% yoy). Zinc ore availability should fall by 1.4% yoy thanks to the ongoing sharp fall in supply outside China (-9.4% yoy). Refined metal supply should remain more or less stable (+0.5% yoy), in the face of a rise in output in China (+4.0% yoy), offset by a fall in supply in the rest of the world (-2.3% yoy), mainly in the United States, Iran and India.

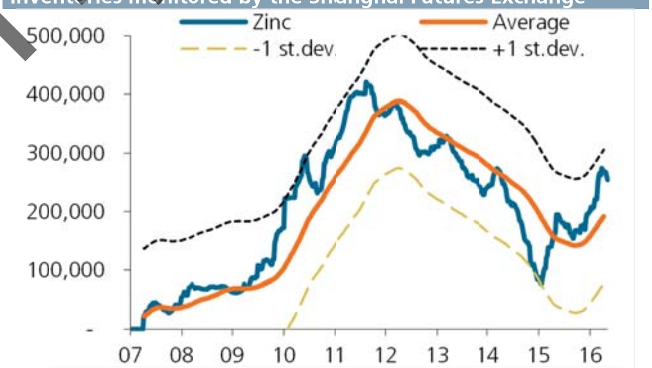
For zinc too, the sharp fall in stocks at the LME is positive, but it mainly reflects a relocation of the metal toward private warehouses or deposits in Asia, in view of the reduced attractiveness of inventory financing deals and the new LME regulations aimed at eliminating the long delivery queues which had paralysed the zinc and aluminium markets.

Inventories monitored by the London Metal Exchange



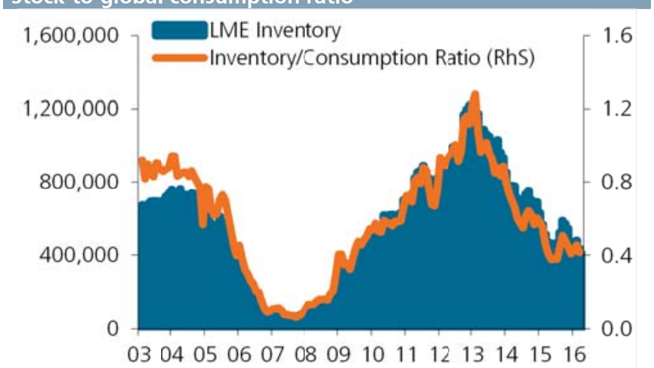
Source: Intesa Sanpaolo chart from Bloomberg data

Inventories monitored by the Shanghai Futures Exchange



Source: Intesa Sanpaolo chart from Bloomberg data

Stock-to-global consumption ratio



Source: Intesa Sanpaolo chart from LME, WBMS data

Prices of the 3-month futures on the LME

Source: Intesa Sanpaolo chart from LME data

Lead

We estimate an average lead price of USD 1,750 a tonne in 2Q16 and an average price of USD 1,745 a tonne for the whole of 2016. At the moment, we stand by our forecast that lead will maintain a wide trading range for most of 2016 due to the overall weak fundamentals of supply and demand, after the improvement recorded in the second half of 2015. In addition, the stocks at the main exchanges and the stock-to-global consumption ratio show signs of essential stability.

As regards the fundamentals of supply and demand, the latest data published at the end of April by the ILZSG shows that oversupply should rise to 76 thousand tonnes in 2016, mainly because of the planned increase in production capacity in Korea. In 2016 we anticipate a rise in global demand by 2% yoy, driven by increased consumption in Europe (+3.5% yoy) and a rebound in US demand (+1.0% yoy). In China, consumption will not be particularly brilliant because of the slowdown in the sales of e-bikes and growing competition from lithium batteries. Lead ore availability should increase slightly (by barely +0.5% yoy), since the rapid acceleration in China should more than compensate for the falls in the rest of the world. Supply of refined metal should grow by 2.3% yoy due to increased processing activities in China and, above all, Korea.

Our long-term prices estimates are also conservative. We forecast slight rises to an average price of 'only' USD 1,900 in 2019. In particular, we are concerned by growing competition from other types of batteries in both the automotive and electric sectors. For instance, in the electric car sector we are witnessing innovations in lithium batteries, which have led to significant reductions in costs and improvements in performance.

In the short term, we feel that the main risk factors to our forecasts are represented by new negative surprises in the macroeconomic scenario and possible abnormal weather conditions, since temperatures well above average could temporarily intensify the demand for battery substitution during the summer period.

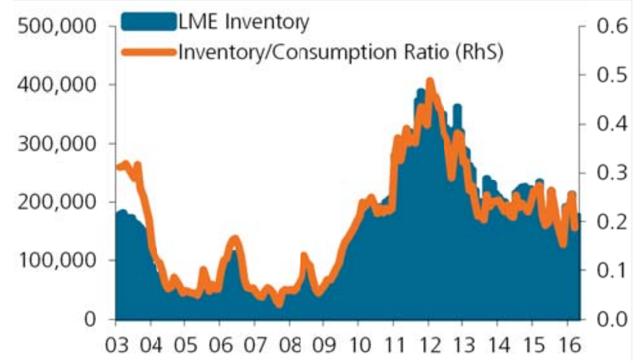
Inventories monitored by the London Metal Exchange

Source: Intesa Sanpaolo chart from Bloomberg data

Inventories monitored by the Shanghai Futures Exchange

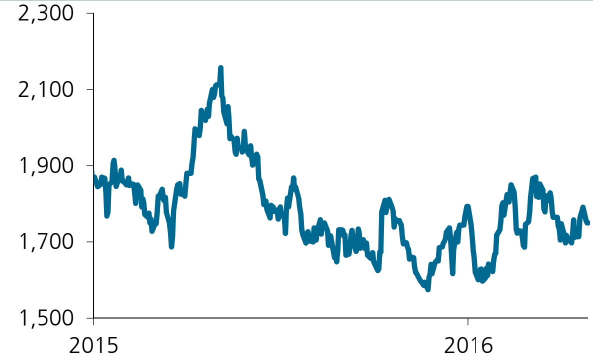
Source: Intesa Sanpaolo chart from Bloomberg data

Stock-to-global consumption ratio



Source: Intesa Sanpaolo chart from LME, WBMS data

Prices of the 3-month futures on the LME



Source: Intesa Sanpaolo chart from LME data

Iron ore and steel sector

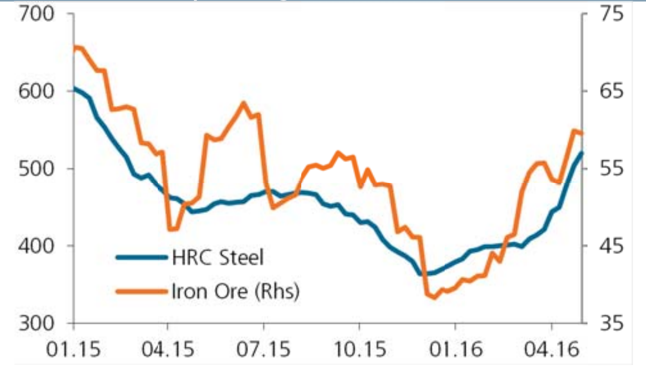
In the case of **steel**, using as a benchmark the index published by The Steel Index, calculated as a weighted average of the prices paid for US hot-rolled coil, **we estimate an average price of USD 470 per tonne for 2Q16 and an average price of USD 457 for all of 2016**. As regards **iron ore**, taking as a benchmark the one-month futures contract listed on the Singapore Exchange, based on a basket of reference prices published by The Steel Index, we estimate **an average price of USD 58 per tonne for 2Q16 and an average price of USD 54 for all of 2016**. Our end-of-year target is USD 60. In view of the high level of supply and the plans to expand production capacity, which should come into effect over the next few quarters, we think that a slight retracement of the prices over the short term is justified and then we expect a stabilisation around the 60 level in 2017, a value estimated on the basis of supply and demand fundamentals and marginal costs.

Iron ore and steel have recorded a strong rally since the start of the year, guided by the perception of an improvement in conditions in the Chinese property sector and the actual strengthening of domestic demand, especially for certain selected steel products.

However, the baseline scenario for steel remains negative: continuing oversupply in China, despite the first hesitant signs of a slowdown in production, will fuel the large surplus on the global market for some time yet and boost Chinese exports. Indeed, despite the restructuring of the sector over the last few years, the various merger and acquisitions made by the key players have not resulted in the closure of several plants, while the smallest producers have continued to grow and gain market shares. Consequently, attempts to consolidate the sector and reduce oversupply have thus far proved unsuccessful. The latest estimates indicate an average capacity utilisation rate of around 70%, which inevitably means extremely low or negative margins. Several times, the authorities have reiterated their commitment to restructure the steel sector and favour the closure of non-competitive or loss-making companies before 2020. However, we do not see any significant changes in progress at the moment and we are sceptical about the implementation of rigorous reforms in the sector, because of the serious negative repercussions these would have on the domestic labour market, which would be unacceptable for the government.

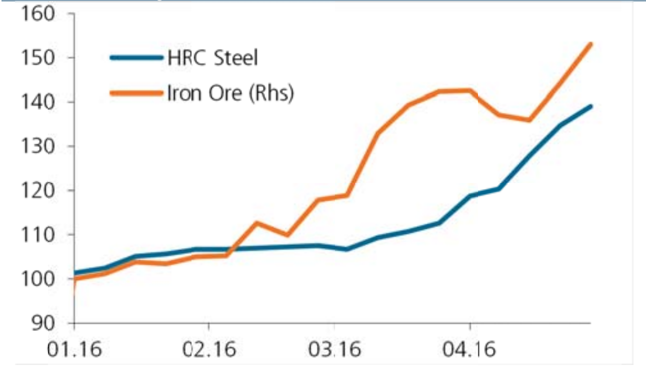
Based on our scenario, we expect that Chinese steel exports will continue to remain high in terms of volumes, but we forecast a considerable slowdown in growth rates, which should be below 10% yoy. Our baseline scenario forecasts stable annual Chinese export volumes. Over the whole of 2014, the volumes exported grew by 50% yoy and rose by 20% yoy in 2015 to a record of 112.6 million tonnes, with a monthly maximum high of 11.3 million tonnes in September 2015 (+51% yoy).

Steel and iron ore prices (right axis) in absolute terms…



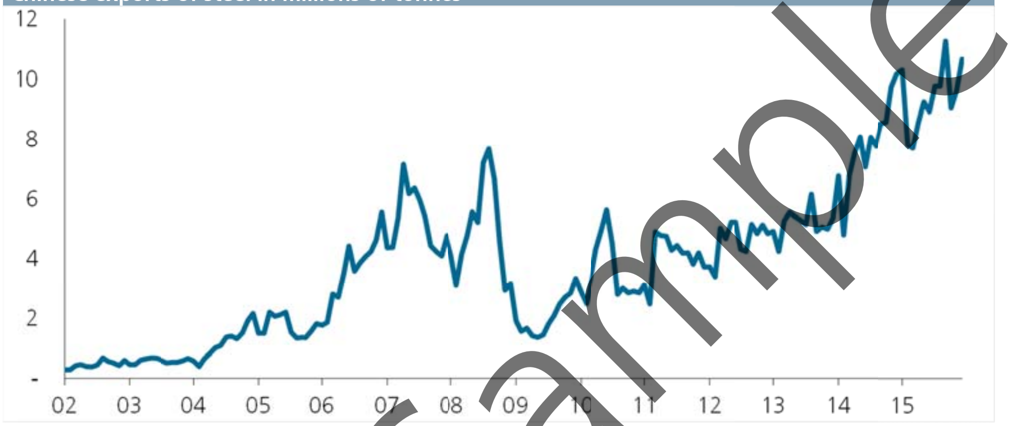
Source: Intesa Sanpaolo chart from The Steel Index (TSI) figures. Steel: TSI USA Domestic Hot Rolled Coil (FOB Midwest mill) in USD/tonnes Iron ore: 1-month futures contract listed on the Singapore Exchange in USD/tonne

… and related yields (Dec. 2015=100)



Source: Intesa Sanpaolo chart from The Steell Index figures and Singapore Exchange

Chinese exports of steel in millions of tonnes



Source: Intesa Sanpaolo chart from Bloomberg data

Forecasts for precious and industrial metals

Price forecasts for precious and industrial metals (in USD)

Intesa Sanpaolo Estimates	2Q16	3Q16	4Q16	1Q17	2016	2017
COMEX GOLD	1,200	1,150	1,150	1,100	1,170	1,125
COMEX SILVER	15.8	16.0	16.7	17.0	15.8	16.8
COMEX PLATINUM	975	1,000	1,020	1,020	978	1,050
COMEX PALLADIUM	550	575	590	600	560	625
LME COPPER 3M	4,764	4,850	4,950	4,900	4,810	5,050
LME ALUMINIUM 3M	1,500	1,525	1,540	1,550	1,520	1,600
LME NICKEL 3M	8,650	8,985	9,055	9,100	8,810	9,275
LME ZINC 3M	1,800	1,880	1,900	1,900	1,817	1,925
LME LEAD 3M	1,750	1,740	1,750	1,750	1,745	1,800
SGX IRON ORE	58	55	57	60	54	60
TSI US HRC STEEL	470	475	480	470	457	483

Source: Intesa Sanpaolo calculations. Iron ore: 1-month futures contract listed on the Singapore Exchange and based on a basket of reference prices published by The Steel Index. Steel: The Steel Index, calculated as the weighted average of prices paid for US hot rolled coil steel transactions

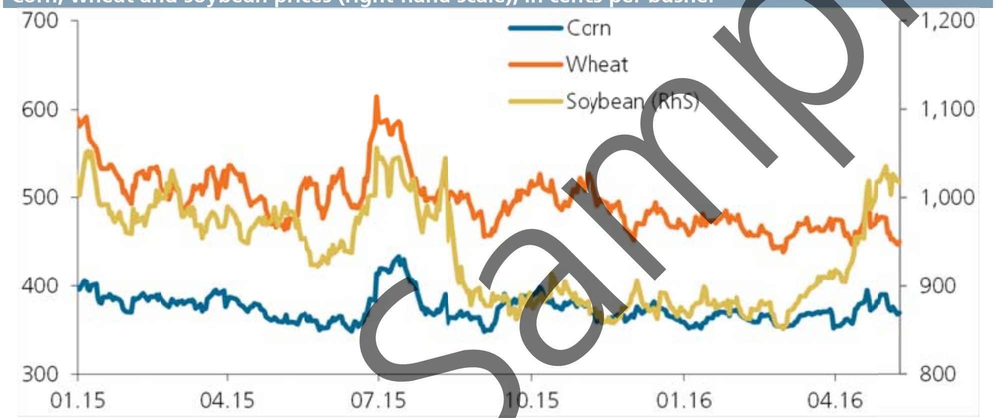
Agricultural commodities: volatility linked to meteorological risks, but wide stocks

The fundamentals of supply and demand for the main cereals remain extremely weak, as shown by the ample ending stocks, but an improvement is forecast. In the short term, the volatility in the sector will be heightened by the uncertainty regarding the meteorological conditions in South America and United States.

Since the start of the year, the performance of the main cereals has been good, thanks to the apparent improvement in the fundamentals and concerns that particularly unfavourable meteorological conditions could compromise the corn and soybeans harvests in South America. At the time of writing, fears about harvests and shipments from Argentina and Brazil have eased. However, as the season goes on, attention will switch to the harvest conditions in the United States. Volatility in the sector will be heightened by forecasts concerning the development of the El Niño phenomenon, which should come to an end over the next few months and may be replaced by the La Niña phenomenon, which often alters climate patterns across vast areas.

We consider as benchmarks the futures listed on the Chicago Board of Trade for corn (CBOT Corn), wheat (CBOT Wheat) and soybeans (CBOT Soybean).

Corn, wheat and soybean prices (right-hand scale), in cents per bushel



Source: Intesa Sanpaolo chart from Chicago Board of Trade data

Corn

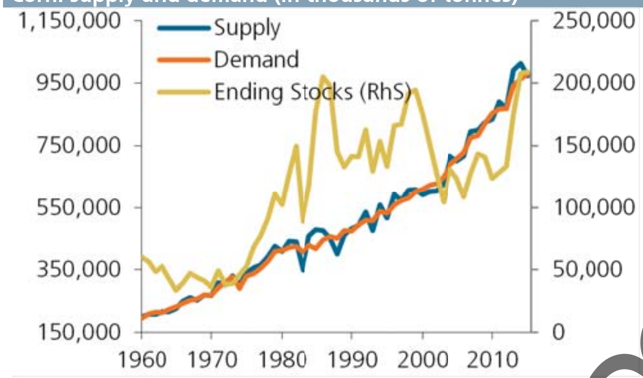
In the April World Agricultural Supply and Demand Estimates (WASDE) report published in April, the US Department of Agriculture (USDA) estimates global corn production of 972.13 million tonnes in the 2015-16 season (revised slightly upwards from the 969.64 million estimated in March), significantly down from 1012.84 million in the 2014-15 season. Global consumption is expected to fall to 970.80 million tonnes (revised upwards from the previous estimate of 967.78 million tonnes) from 980.29 million tonnes recorded in the previous season. Given the wide gap between supply and demand, ending stocks should rise to 208.91 million tonnes (revised upwards from 206.97 million in March) from 207.58 million tonnes in the previous season. The stock-to-consumption ratio should therefore rise to 21.5% after recording 21.2% in the previous season, reaching the highest level since the 2001-02 season.

At present, **we estimate an average price of USD 385 cents a bushel for 2Q16 and an average of USD 373 cents for all of 2016**. We therefore expect that prices will remain close to the high levels recorded in April for another couple of months. We then expect a retracement toward a target of USD 370 before the end of the year.

At the moment, we forecast that production will remain abundant, although lower than in the 2014/15 season record. Ending stocks and the stock-to-consumption ratio are forecast to be more or less stable and we therefore suggest that the market will remain well supplied for some time yet.

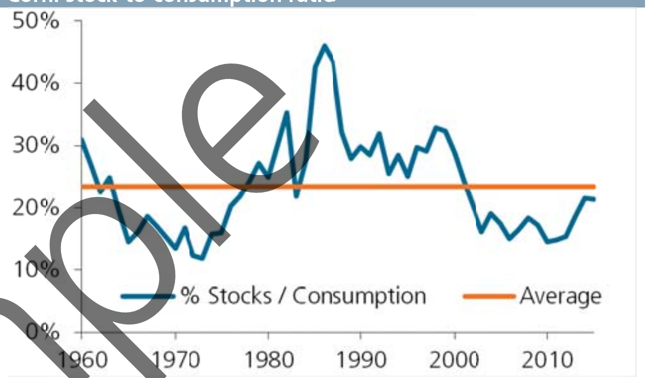
As regards the consumption of corn linked to the production of ethanol in the United States, we expect an overall stability in this demand component. Indeed, the EIA expects that the production of ethanol will be between 970 thousand and 980 thousand barrels per day (b/d) for the 2016-17 period, in line with what has been produced since the start of the year (975 thousand b/d). Compared with production in April (945 thousand b/gd on average), we should see a rise in demand for corn, but we think that this component has already been fully incorporated into the prices.

Corn: supply and demand (in thousands of tonnes)



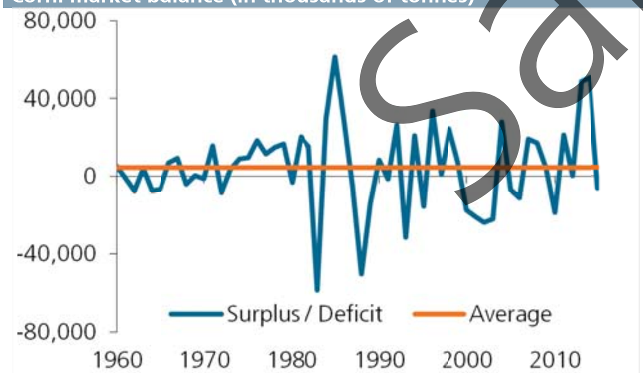
Source: Intesa Sanpaolo chart from USDA data

Corn: stock-to-consumption ratio



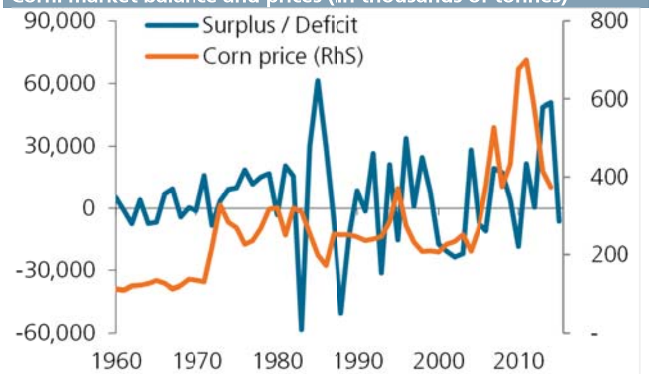
Source: Intesa Sanpaolo chart from USDA data

Corn: market balance (in thousands of tonnes)



Source: Intesa Sanpaolo chart from USDA data

Corn: market balance and prices (in thousands of tonnes)



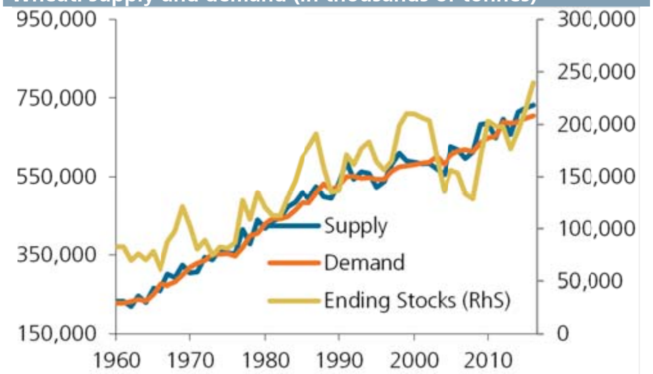
Source: Intesa Sanpaolo chart from USDA data

Wheat

In the April WASDE report, the USDA estimates that the 2015-16 season will see a rise in global wheat production, which is expected to increase to 733.14 million tonnes (revised slightly upwards from 732.32 million tonnes in the March report) from 725.44 million tonnes in the 2014-15 season. Global consumption is expected to rise to 708.69 million tonnes (revised downwards from 709.37 million tonnes) from 704.56 million tonnes recorded in the previous season. Ending stocks are expected to increase rapidly to 239.26 million tonnes (revised slightly upwards from 237.59 million tonnes in March), from 214.80 million tonnes recorded in the previous season. The stock-to-consumption ratio is therefore expected to rise to 33.8% from the previous 30.5%.

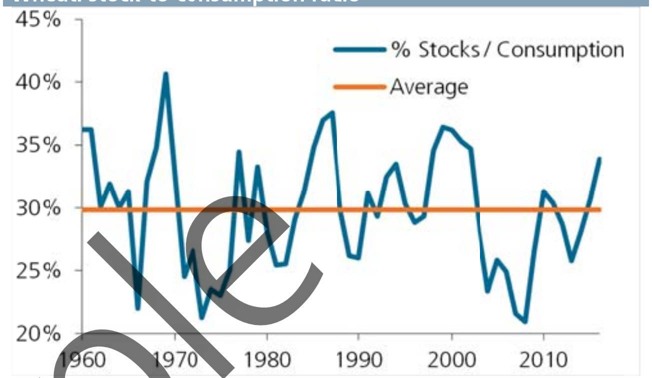
Overall, we maintain the expectation of a gradual decrease in prices during the year and **we estimate an average price of USD 470 cents per bushel for 2Q16 and an average of USD 456 cents for all of 2016**. Wheat is currently the cereal with the worst fundamentals. The considerable stocks and the marked deterioration in the stock-to consumption ratio are of particular concern. Consequently, we expect a correction to a target of USD 440 for the end of the year. Obviously, the main upside risk affecting our scenario is the particularly negative meteorological conditions in the main producing regions, particularly Eastern Europe and the United States.

Wheat: supply and demand (in thousands of tonnes)



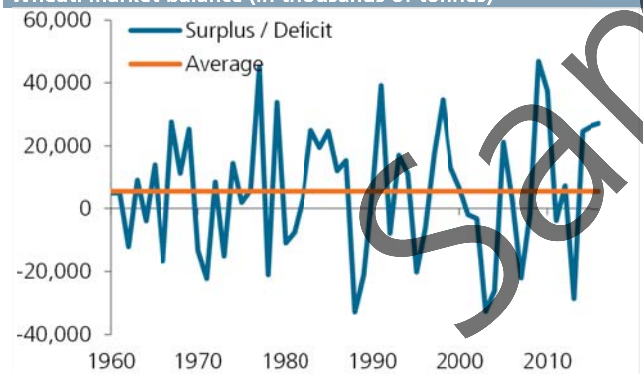
Source: Intesa Sanpaolo chart from USDA data

Wheat: stock-to-consumption ratio



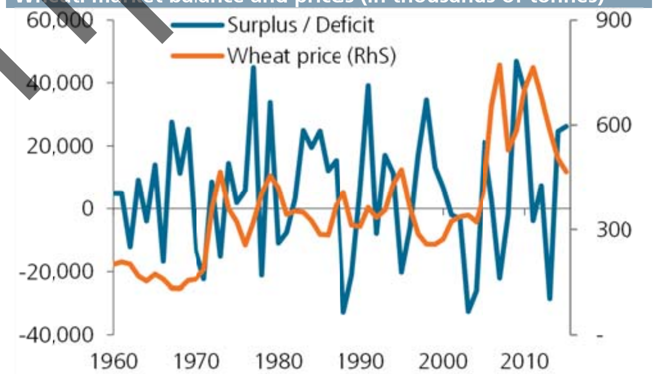
Source: Intesa Sanpaolo chart from USDA data

Wheat: market balance (in thousands of tonnes)



Source: Intesa Sanpaolo chart from USDA data

Wheat: market balance and prices (in thousands of tonnes)



Source: Intesa Sanpaolo chart from USDA data

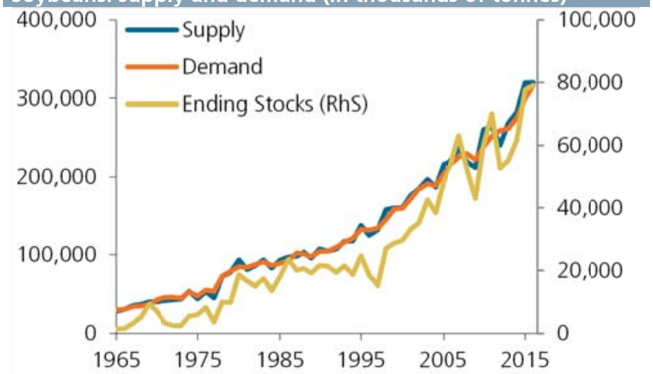
Soybeans

In the 2015-16 season, the USDA estimates an increase in global stocks of soybeans, reaching 79.02 million tonnes in the 2015-16 season (revised slightly upwards from 78.87 million estimated in March), from 77.73 million in the previous season. Production is expected to rise slightly to 320.15 million tonnes (essentially unchanged from the March estimate of 320.21 million tonnes), from 319.55 million tonnes in the 2014-2015 season. Global consumption is expected to rise to 316.35 million tonnes (revised marginally upwards from 315.75 million tonnes) from 299.69 million tonnes recorded in the previous season. The stock-to-consumption ratio is therefore expected to fall to 25.0% from the 25.9% recorded in the previous season.

We estimate an average price of USD 950 cents a bushel for 2Q16 and an average of USD 931 cents for all of 2016. Despite the fact that the fundamentals are actually improving, we believe that soybeans rose too quickly due to fears linked to the unfavourable meteorological conditions in South America and we expect a price correction over the next few months, when the data flow from the producing countries will ease fears concerning the extent of the damage.

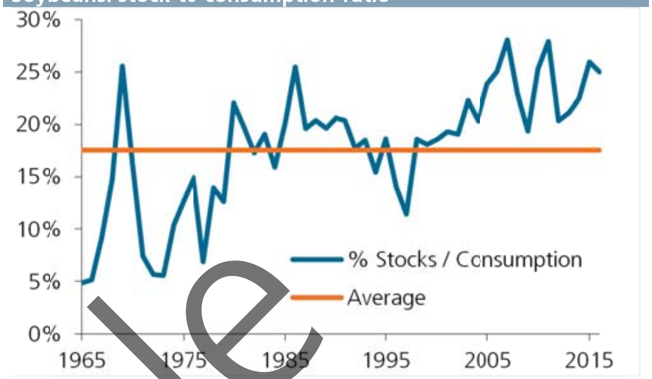
As regards the global vegetable oils market, the fundamentals for soybean oil are becoming tighter. The stock-to-consumption ratio is expected to fall to 7.3%, from 7.7% in the previous season, much lower than the 8.0% recorded in the 2013-14 season. Indeed, consumption is expected to grow much more rapidly than ending stocks, where the USDA estimates a slight rise to 3.74 million tonnes in the 2015-16 season (revised upwards from 3.65 million in March) from 3.69 million tonnes in the 2014-15 season.

Soybeans: supply and demand (in thousands of tonnes)



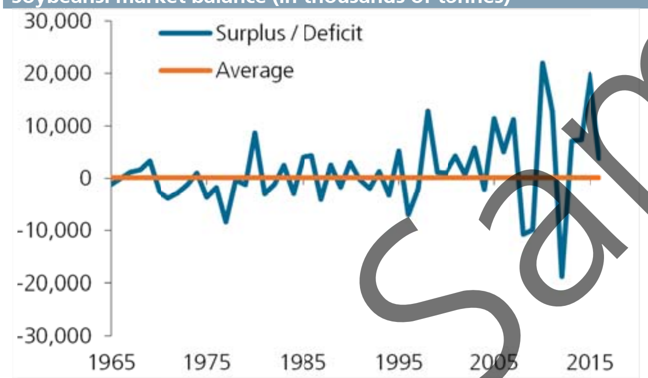
Source: Intesa Sanpaolo chart from USDA data

Soybeans: stock-to-consumption ratio



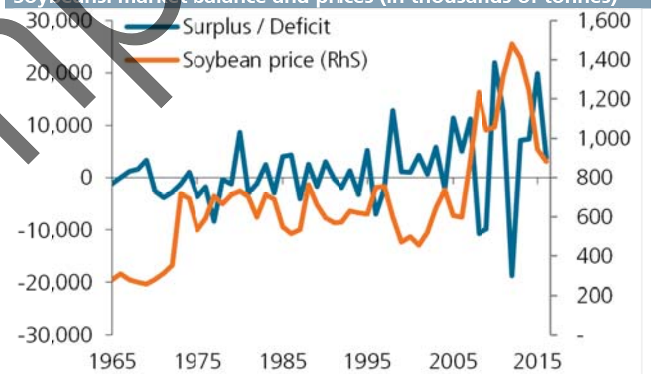
Source: Intesa Sanpaolo chart from USDA data

Soybeans: market balance (in thousands of tonnes)



Source: Intesa Sanpaolo chart from USDA data

Soybeans: market balance and prices (in thousands of tonnes)



Source: Intesa Sanpaolo chart from USDA data

Forecasts for cereals

Price forecasts for the main cereals (in USD)

Intesa Sanpaolo Estimates	2Q16	3Q16	4Q16	1Q17	2016	2017
CBOT CORN	385	375	370	370	373	375
CBOT WHEAT	470	450	440	440	456	460
CBOT SOYBEAN	950	950	945	940	931	915

Source: Intesa Sanpaolo estimates

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Appendix

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