PICTET WEALTH MANAGEMENT

Precious metals: Gold

Gold rush

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FLASH NOTE

SUMMARY

- Gold prices have moved relentlessly higher since the start of March, reaching new all-time highs in US dollar.
- Higher gold prices have been supported by strong underlying demand for the yellow metal from various traditional sources as well as from global futures markets.
- In the short term, gold may be vulnerable to a deterioration in jewellery and central banks demand as well as high opportunity costs.
- In the medium term, we continue to see gold as attractive and there are upside risks to our current 12-month projection of USD2,350 per troy ounce.

HIGHER GOLD PRICES BOOSTED BY STRONG DEMAND

The recent strong rise in gold prices highlights the underlying strong demand for gold. This demand is driven by a range of factors and is especially visible in Asia.

Since the application of Western sanctions on Russian FX reserves in early 2022, demand for gold from the official sector (central banks and other institutions such as sovereign wealth funds) has surged, suggesting a new demand equilibrium well above the previous one of roughly 500 tonnes per annum. Reported demand from China's central bank, roughly 300 tonnes since March 2022, was twice that of the second-largest central bank buyer.

Despite high prices, jewellery demand for gold appears resilient, likely boosted by seasonal year-end effects in the west and the Lunar New Year in China. General pent-up demand in China after the lifting of Covid restrictions at the end of 2022 may also still be in play.

Interestingly, investment demand has also been resilient despite strong outflows from gold ETFs. Demand for bars and coins was roughly unchanged in 2023 despite

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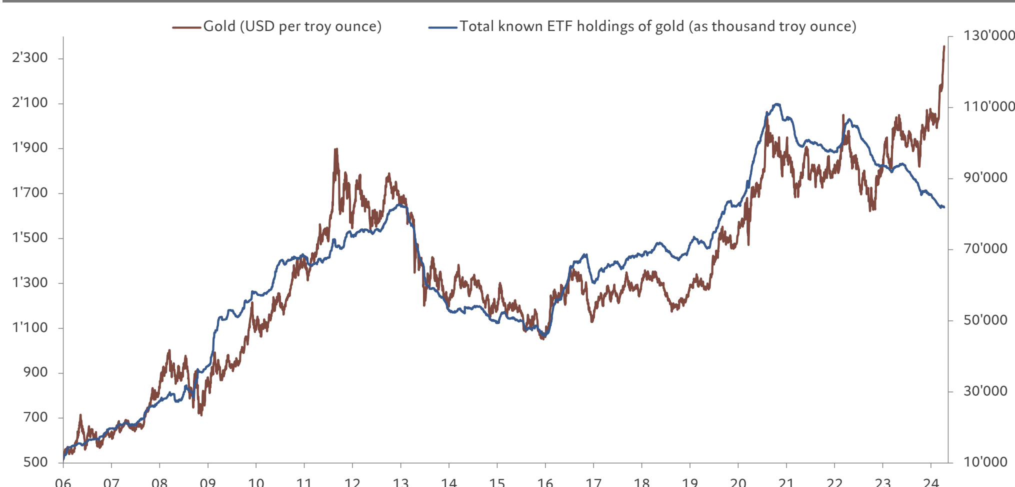
rising opportunity costs and was particularly visible in India and China. While a strong economy may have been a factor in boosting physical demand for gold among Indian investors, their counterparts in China may have turned to gold because of concerns over the value of the renminbi together with the poor performance of domestic assets, including real estate. Elevated domestic inflation likely explains why physical demand from Turkey has been strong in recent quarters.

Overall, the rise in official and jewellery demand as well as for gold bars and coins has more than compensated for the decline in ETF demand (*see chart 1*), which now accounts for a lower share of total gold demand than in the past. That said, as the marginal buyers and sellers of gold, swings in ETF demand combined with equally volatile derivatives demand remain very important for gold prices.

Chart 1: Gold price and ETF gold demand



Source: Pictet Wealth Management, Bloomberg Finance L.P., as of 11.04.2024

A REBOUND IN ETF DEMAND COULD LEAD TO HIGHER GOLD PRICES

The considerable opportunity costs of owning non-yielding gold at a time of high bond yields could remain a drag for ETF demand for gold.

That said, an imminent Fed easing cycle, sticky US inflation or growing concerns over the US fiscal outlook could each fuel a rebound in ETF demand. The record-high gold price in nominal terms may also attract demand. Indeed, we have lately seen tentative signs of a stabilisation in ETF demand. This needs to be confirmed, but we remain of the view that ETF demand is likely to improve this year, providing support for gold prices.

Contrary to ETFs, derivatives demand has been strong since last October (notably due to geopolitical tensions) and increased further in March—probably because US futures markets early in the month were still looking forward to Fed rate cuts. Expectations for Fed easing have faded since mid-March but have been compensated for by further increases in demand from Chinese derivatives, as borne out by the four-year high in trading volume reported on the Shanghai gold futures market in April (*see chart 2*).

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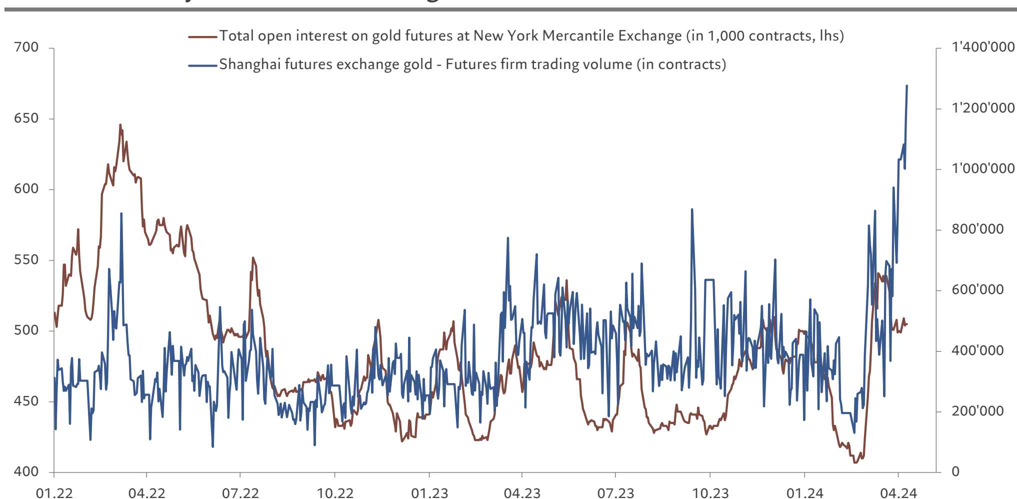
All in all, the significant upswing in gold prices is likely due to resilient demand from a variety of sources. While the prospect of Fed easing may have kick started the gold rally, it is likely that momentum investors, especially in China, have been pulled in by the break to the upside of technical price levels at around USD2,090 per troy ounce.

Chart 2: Activity in US and Chinese gold futures market



Source: Pictet Wealth Management, Bloomberg Finance L.P., as of 11.04.2024

GOLD PRICE LOOKS OVEREXTENDED IN THE SHORT TERM

However, after a big rise in March, the large deviation from their 200-day moving average suggests that gold prices are overextended (*see chart 3*). The rise in 10-year real rates in the US since the start of the year could be a drag on investment demand in the West (notably through ETFs and futures). And jewellery demand could start to suffer from high gold prices. Also, while central bank demand represents only a portion of official demand, it declined from November through to end-February. By contrast, demand for bars and coins in developing economies could remain firm. The gold premium in India and China (i.e. the difference in USD gold prices in local Indian and Chinese exchanges and the London gold price, which can be seen as a proxy for the strength of local physical demand) has improved somewhat in recent weeks.

Overall, we could see a short-term pullback in the gold price but given the multitude of drivers behind the recent rise in prices, gold could find support at around USD2,100-2,200 per troy ounce (vs. USD2,332 on 10 April).).

GOLD REMAINS ATTRACTIVE ON A LONGER-TERM BASIS

Beyond tactical concerns, gold remains an attractive asset on a longer-term basis. Official demand is likely to remain strong in the coming years as Western sanctions on Russian FX reserves push central banks to further increase their allocations to gold. The possibility of Fed easing, increasing US fiscal deficits, sticky above-target inflation, ongoing concerns over the performance of Chinese assets and structurally

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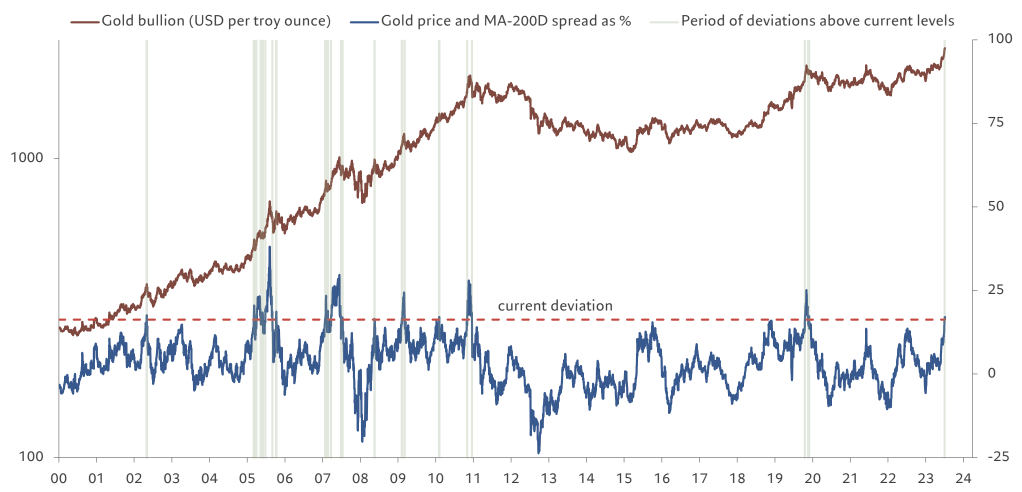
higher geopolitical uncertainties are all further potential drivers of higher investment demand.

Our current 12-month projection of USD2,350 looks somewhat timid compared to current prices and is likely to be upgraded when we have more visibility on Asian demand. But any upward adjustment is unlikely to be sharp. Official demand should remain strong but is unlikely to increase above 2022 levels while jewellery demand could decline on the reduced affordability of gold. Finally, physical demand in China may not increase much from current high levels should the Chinese economy regain some momentum.

Chart 3: Gold prices and their deviations to the 200-day moving average



Source: Pictet Wealth Management, LSEG, as of 11.04.2024

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