PRECIOUS METALS

OUTSHINED BY THE FED

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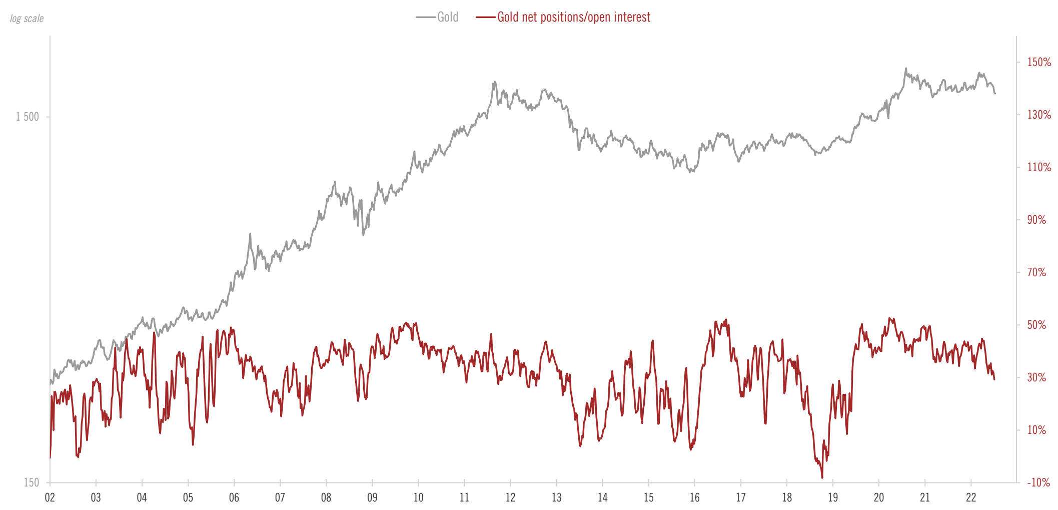
SUMMARY

- Precious metals have been hit hard by an ever hawkish Fed, high interest rates and a strong US dollar.
- In the short term, we see gold as the most resilient precious metal, given rising recession concerns.
- In the longer term, the structural shift towards green energy should lead to stronger industrial demand for silver and platinum, whereas palladium is likely to suffer from the shift.

CHART 1: GOLD VS. NET GOLD POSITIONS IN THE FUTURES MARKET



Source: Pictet's wealth management division – CIO Office & MR, Refinitiv, 15 July 2022

Gold: waiting for a less hawkish Fed

Gold is mostly driven by investment demand, which in turn depends on the attractiveness of gold as a hedge against a decline in US dollar value, against high inflation and against general economic uncertainties. Investment demand is also significantly impacted by the opportunity cost of holding non-yielding gold.

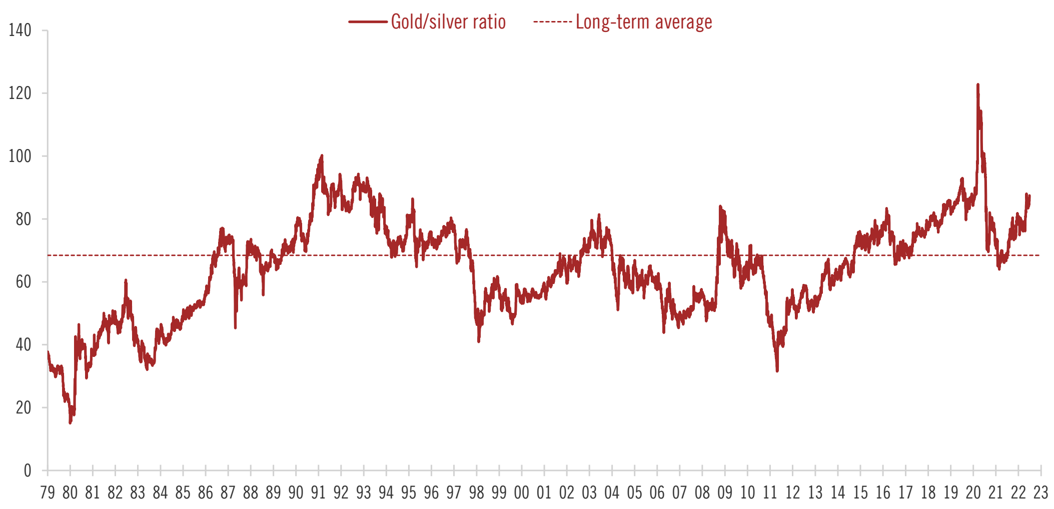
Currently, the Fed's monetary stance is particularly aggressive (brushing off recessionary noise), supporting a strong US dollar. Coupled with the high opportunity cost (given a positive US 10-year real interest rate), investment demand is unlikely to prove particularly supportive for gold, despite high inflation. A peak in US inflation and clearer signs of a marked deterioration in the US economic outlook are likely needed for the Fed to turn more sensitive to the recessionary narrative.

A Fed that softens its monetary stance, driven by economic growth concerns, would likely weigh on interest rates. Such environment may also prove less supportive of the US dollar. While global risk appetite may improve as the Fed returns to its old habits of nurturing the economic growth, the elevated global geopolitical tensions following the war in Ukraine are likely to last and could keep gold as an attractive option for investors looking for an hedge against global uncertainties.

However, in the short term, US job and inflation data for June are definitively not favouring a softer Fed monetary stance (market expectations even point towards front-loading rate hikes for the next few meetings), which should keep gold under pressure. But our central scenario suggests that the Fed could turn more cautious on rates in September. That would also coincide with a seasonal surge in jewellery demand in the fourth quarter, setting the stage for a more supportive environment for gold. But the yellow metal may remain particularly vulnerable in the next few weeks, especially as sentiment in the futures market is significantly deteriorating from a high base (*see chart*).

Overall, we have decided to lower our three-month projection at USD1,750 per troy ounce (vs. USD1,780) to take into account the recent change in projections for the US dollar and the risk that the Fed remains hawkish longer than previously thought. We also acknowledge that in the next weeks, risks are clearly skewed to the downside (and a test of the key technical threshold at around USD1,680 looks likely). Our six-month and 12-month projections are also adjusted somewhat lower to USD1,820 (vs. USD1,860 previously) and USD1,860 (vs. USD1,900 previously) respectively.

CHART 2 : GOLD PRICE DIVIDED BY SILVER PRICE (A.K.A. GOLD/SILVER RATIO)



Source: Pictet's wealth management division – CIO Office & MR, Refinitiv, 15 July 2022

Silver: waiting for a pickup in industrial demand

The short-term concerns we have on investment demand for gold are also present for silver, with the difference that the decline in investment demand is much more visible in the white metal. With markets increasingly pricing in a recession in the US in the next 12 months, industrial demand is unlikely to provide much help to silver. Weakness in the price of copper, also heavily used in electrical equipment, confirms this assumption.

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To be fair, we think that the shift towards green energy is likely to boost industrial demand for silver, given its usage in electric battery and solar panels. Comparing gold and silver prices, silver looks cheap relative to gold based on past history (*see chart*). Overall, in the longer term, we see scope for silver outperforming gold.

Given our gold projection change, we also adjust our projections for silver. We set our three-month projection at USD19.0 per troy ounce (vs. USD20.0 previously), our six-month at USD20.5 (vs. USD21.5) and our 12-month at USD22.5 (vs. USD23.0 previously).

Palladium: high uncertainties on Russian supply

The high uncertainty linked to Russian supply (which represents roughly 40% of total supply) should keep palladium particularly volatile. In the longer term, the prospect of declining Russian supply as mining activities may ultimately be affected by economic sanctions could weigh on global supply.

As palladium demand is mostly linked to the auto sector, China's reopening and strong global demand for cars after numerous quarters of limited availability points towards stronger car demand. That said, the probable deterioration in the labour market as economic activity slows and the increasing market share of electric vehicles could significantly weigh on palladium industrial demand. Also, given the expensiveness of palladium relative to platinum and the higher uncertainty on Russian supply, automotive use of palladium is likely to underperform that of platinum.

Overall, we keep our forecasts unchanged with both three and six-month projections at USD1,900 per troy ounce and a 12-month projection at USD1,800.

Platinum: brighter prospects for automotive demand than palladium

Similar to palladium, platinum is likely to benefit from improving automotive demand. That said, platinum demand is more diversified than palladium, as, for example, jewellery demand represents a significant share of total platinum demand (roughly 25%).

Platinum supply is not highly reliant on Russia, as most of the production comes from South Africa. But ongoing wage negotiations in South Africa, in an environment of rising inflation, could lead to strikes in the second half of the year, which could have a temporary impact on platinum supply. We think that platinum is set to significantly outperform palladium over the next years, because it is less exposed to the structural increase in market share of electric vehicles. In the green transition, platinum can play a significant role in fuel cell technology.

Despite such preference, we have decided to revise our projections on platinum lower, because of its price correlation with gold. The three-month projection is now at USD850 (vs. USD900 previously), the six-month projection at USD950 (vs. USD1,000 previously) and the 12-month projection at USD1,050 (vs. USD1,150 previously).

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