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PICTET WEALTH MANAGEMENT

Precious Metals: Gold

On a more volatile path

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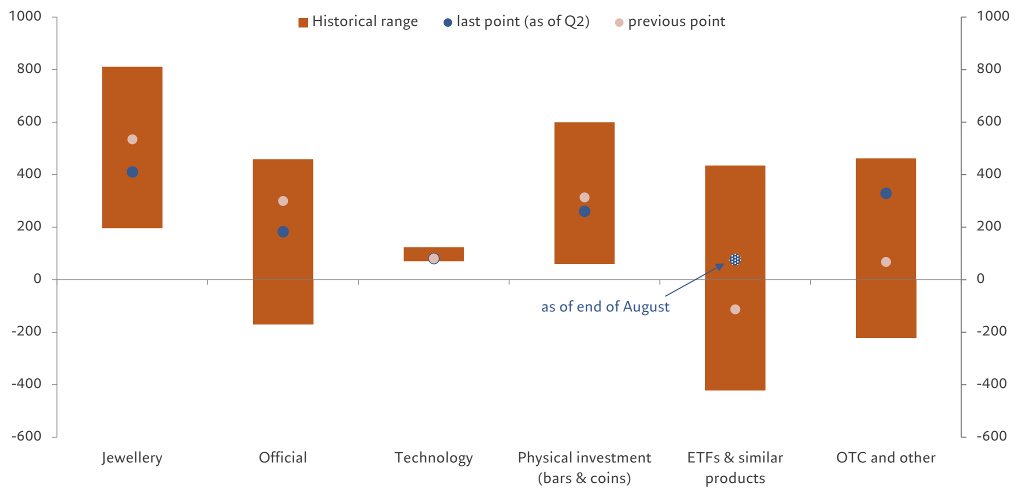
FLASH NOTE

SUMMARY

- Gold prices remain on an upward path, as confirmed by the fresh all-time highs it has reached in recent days.
- The nature of gold demand shows signs of shifting. High gold prices have begun to weigh on demand from central banks and China, whereas the decline in US rates and market uncertainties have pushed OTC and ETF demand higher.
- We maintain our medium-term bullish view on gold. Our 12-month projection is USD2,650 per troy ounce. Our three-month projection of USD2,500 balances improvements in investment demand against the relatively stretched level of speculative OTC demand.

Chart 1: Gold demand (in tonnes, quarterly data since 2004)



Source: Pictet Wealth Management, World Gold Council, as of 16.09.2024

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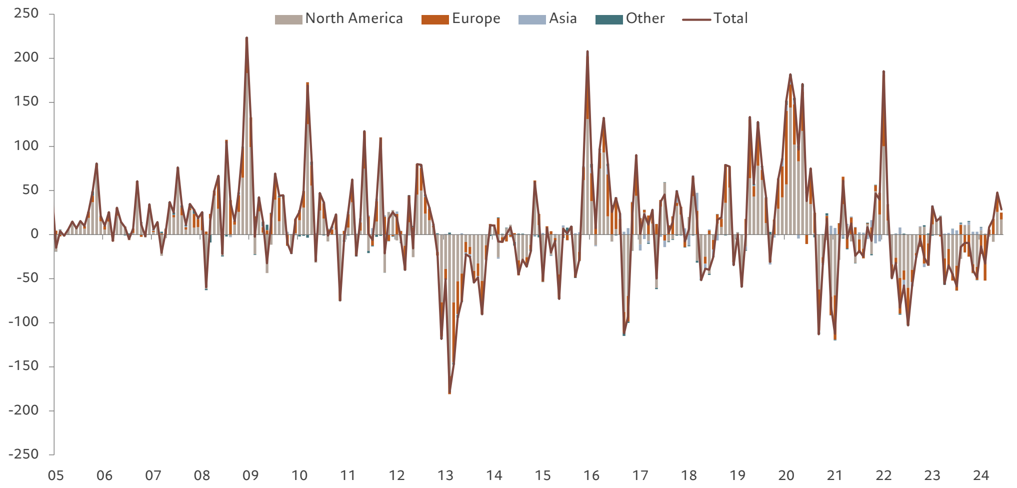
GOLD PRICES AT ALL-TIME HIGHS

Gold demand has proven resilient in the face of rising gold prices, which reached a record high (in US dollars) on 13 September. But while gold prices remain on an upward trend, the sources of gold demand are showing signs of shifting (*chart 1*).

Over-the-counter (OTC) demand surged in Q2, as can be seen in the sharp increase in speculative net long gold positions in the US futures market. ETF demand has also recovered after two years marked by ETF disinvestment *(chart 2)*. At the same time, official demand has abated, weighed down by high gold prices, while Chinese physical demand has declined significantly in recent months.

Chart 2: ETF gold demand (in tonnes)



Source: Pictet Wealth Management, World Gold Council, as of 16.09.2024

ETF AND OTC DEMAND ARE IN THE FRONT SEAT

A key driver for ETF demand is the opportunity costs involved in holding a metal that pays no interest. Declining US economic momentum and the shift to a more accommodative stance by the US Federal Reserve have led to lower US interest rates. As a result, the cost of buying gold as a hedge against market uncertainties has declined. Looking forward, the start of the Fed's easing cycle this week should support ETF demand for gold over the coming months. Interestingly, data from the World Gold Council suggest that ETF demand wavered during recent episodes of financial market weakness (i.e. early August and early September). So, any sustained decline in the US stock market may not necessarily prove very positive for gold in absolute terms.

OTC demand for gold, as proxied by money-managed positions in the US futures market *(chart 3)*, has continued to improve. Such speculative demand is likely driven by factors such as geopolitical concerns, the deteriorating US fiscal outlook, uncertainties related to the US elections, the Fed's increasingly dovish monetary stance and the upward trend in gold prices (as momentum investors tend to use gold derivatives to gain exposition). As with ETF demand, we see limited reasons for a major shift in OTC demand, at least until the US elections in November.

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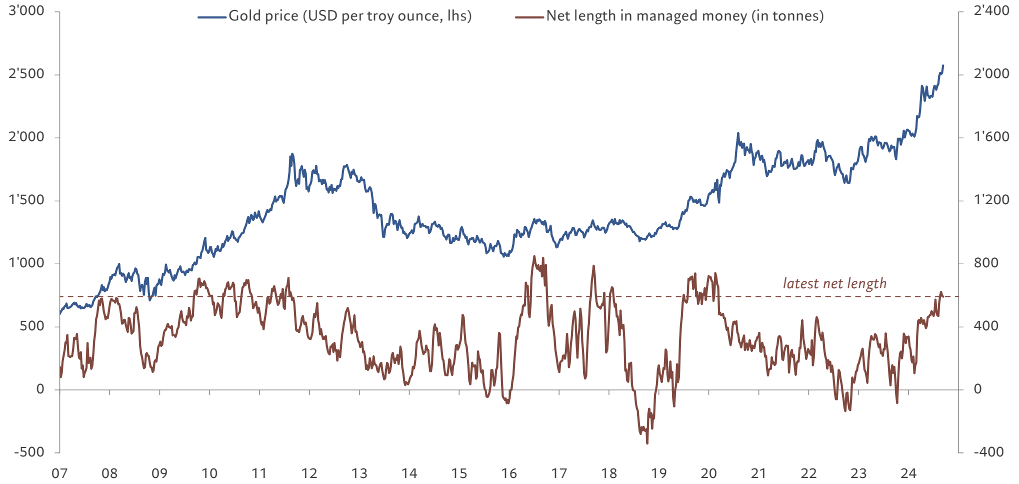
Historically, ETF and futures demand has been critical in shaping trends in gold prices, but it is also very volatile (particularly OTC demand). And while we see scope for a further rebound in ETF demand after two years of disinvestment, OTC demand is already at historically high levels *(chart 1)*.

Chart 3: Gold price vs. net managed-money gold positions in US futures market



Source: Pictet Wealth Management, LSEG, as of 16.09.2024

WEAKER DEMAND FROM CENTRAL BANKS AND CHINA

High gold prices tend to weigh on physical gold demand and may explain the recent slight decline in official demand. Indeed, demand from central banks (as reported to the International Monetary Fund) has turned down in recent months. That said, there have been no reports of significant sales of gold, and demand from Poland's central bank (which aims to have 20% of its reserves in gold), along with ongoing demand from structural buyers such as India and Turkey, suggest the outlook for official gold demand remains robust. Overall, data from the World Gold Council suggest official demand (including demand from central banks and other institutions such as sovereign wealth funds) may hover around 900 tonnes in 2024—slightly lower than 2022-2023 levels but far above the average of 500 tonnes per year in the 2010s.

A bit more concerning is the decline in Chinese demand for physical gold. Chinese imports and Swiss exports of gold together with the Chinese gold premium (the difference in the gold price between the Shanghai gold exchange and London) all point to weak physical demand from China. Part of this weakness may be linked to high gold prices, but also to the overall weakness of domestic consumption in China. While strong Asian physical demand is a key factor in our long-term positive view on gold, we are thus far not too concerned. First, seasonal factors mean Chinese demand is usually negative during summer. Second, concerns over the weakness of the renminbi have receded lately due to the global decline in interest rates. And, depending on the outcome of the November election, concerns over high tariffs on Chinese goods under a new Trump administration could fuel higher gold demand. Third, physical demand out of other parts of Asia in the coming months could be

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robust—thanks in particular to a decline in gold import taxes in India at the end of July (from 15% to 6%).

Overall, while there was some deterioration in physical gold demand during the summer, we see limited risks for a sustained decline.

HIGH GLOBAL UNCERTAINTIES LIKELY TO KEEP GOLD ATTRACTIVE

Alongside demand from central banks keen on accumulating gold to strengthen the inviolability of their FX reserves, current drivers of strong speculative demand should continue to make gold an attractive hedge. The decline in interest rates across the globe lowers the cost of such portfolio insurance. By contrast, gold could suffer if political and economic uncertainties in the US recede in the coming months. Current quite aggressive market pricing of Fed rate cuts could need to be revised if the US economy does not fall into recession.

High-frequency data suggest a pickup in OTC demand, likely driven by technical factors (i.e. price momentum), and expectations of a dovish Fed are behind the record highs reached by gold recently. But short-term price trends are exposed to a reversal in volatile OTC demand, especially in view of the aggressive market pricing of Fed rate cuts.

Overall, we are keeping our medium-term bullish view on gold. We have adjusted higher our 12-month projection to USD2,650 per troy ounce (vs. USD2,550 previously). Our three-month projection is at USD2,500 (vs. USD2,350) to take into account improving investment demand balanced against already stretched levels of speculative OTC demand.

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