PICTET

Precious Metals: Gold

Robust global demand

16 JULY 2024, CIO OFFICE & MACRO RESEARCH

FLASH NOTE

SUMMARY

- Although gold prices are at historical nominal highs, the decline in price-sensitive gold demand has led to weaker price momentum since mid-April.
- While price momentum could remain relatively subdued in the short term, we expect demand to strengthen in the medium term thanks to a rebound in ETF demand and renewed Chinese physical demand.
- In the short term, we see limited scope for a significant decline in demand and therefore we are adjusting upward our three-month projections to USD2,350 per troy ounce. Our 12-month projection is USD2,550.

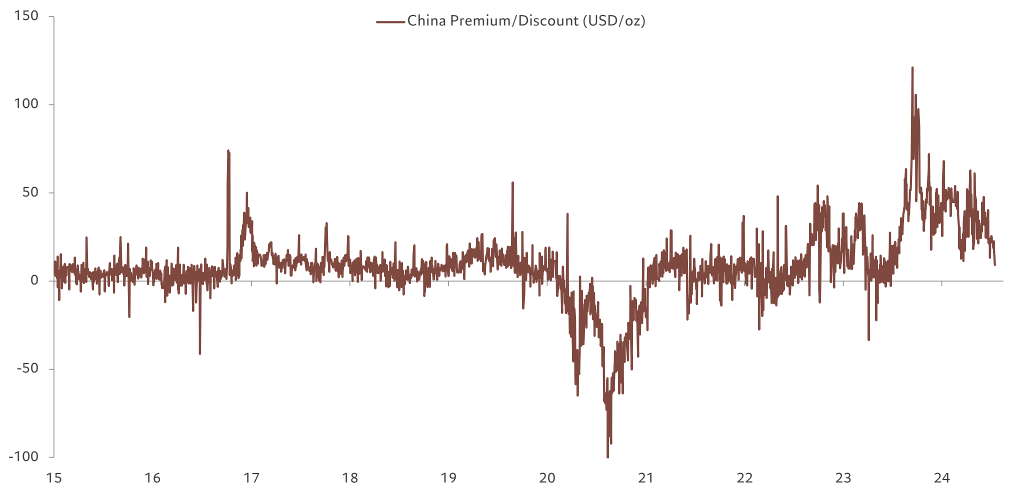
GOLD DEMAND REMAINS HEALTHY

Gold prices have stabilised at historically high levels since mid-April. But demand momentum has slackened because of the high prices. In particular, the reduced affordability of gold and unsupportive seasonality should ensure jewellery demand remains weak until end-August. Central banks with long-term goals to increase their gold allocation may also decide to wait for more attractive prices. Finally, Chinese physical demand for gold, as proxied by the spread between the international (London) gold price and the gold price on the Shanghai gold exchange, has abated recently (*chart 1*).

But other sources of gold demand have been holding up. For example, ETF demand has improved thanks to rising chances that the Fed will start its easing cycle in September, while demand from futures markets has remained strong. In addition, reported demand from central banks is only a portion of official demand. While little is known of current buying, institutions such as sovereign wealth funds eagerly bought gold in Q1.

Overall, although we have seen a relatively mild decline since mid-April, there is little evidence that high gold prices have significantly dented global demand for the yellow metal, meaning the bullish case for gold remains intact.

Chart 1: Chinese gold premium



Source: Pictet Wealth Management, Bloomberg Finance L.P., as of 16.07.2024

ETF AND CHINESE DEMAND LIKELY TO STRENGTHEN

Beyond ongoing strong demand from the official sector, there are two main reasons, in our view, to keep a medium-term positive view on gold. First, we see scope for further improvements in ETF demand after months of disinvestment. The start of a Fed easing cycle should fuel some of this demand for gold as the opportunity costs to own gold would likely decline in line with interest rates (*chart 2*).

Second, Chinese physical demand for gold is likely to strengthen again. Depending on who the next US president is, the threats of higher tariffs on Chinese exports to the US could lead to downward pressure on the renminbi and therefore fuel stronger Chinese demand for gold. Besides the US elections, the Chinese economic outlook remains subdued and domestic monetary policy is unlikely to be tightened soon given low inflationary pressure. The policy mix is therefore not supportive of the renminbi. The increasing number of countries considering curbs on Chinese exports may also add to the downward pressure on the renminbi. Overall, we expect Chinese demand for gold to pick up again in the coming quarters.

The US elections may in reality have a mixed impact on gold prices. Because neither presidential candidate has made a strong case for fiscal consolidation, growing concerns over the US's fiscal sustainability may eventually favour gold, which does not bear any default risk. But Donald Trump's proposals for higher tariffs and reduced immigration could lead to significantly higher inflation and higher interest rates, which may weigh on gold prices through punitive opportunity costs.

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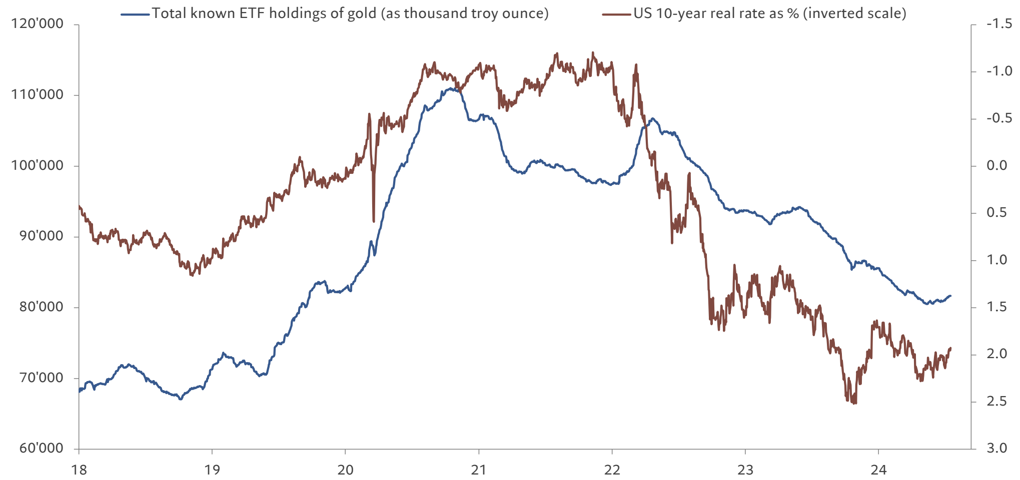
Chart 2: US real rates and ETF demand for gold



Source: Pictet Wealth Management, Bloomberg Finance L.P., as of 16.07.2024

GOLD'S MEDIUM-TERM OUTLOOK REMAINS POSITIVE

Our 12-month projection of USD2,550 per troy ounce symbolises our medium-term bullish outlook on gold (the spot price was USD2,422 on 15 July). However, historically high nominal prices are cutting into demand at present and may mean that gold has little upside potential in the short term. It is also worth noting that prices for other precious metals are currently less robust than for the yellow metal. We suspect that the recent fall in US short-term interest rates and the US dollar has been helping gold prices resist. Given our central scenario, gold may not benefit much more from these two drivers in the short term.

The key risk is obviously that new all-time highs in the gold price kindle another rise in demand from momentum investors. But unlike March (when gold prices surged), positioning in the futures market is already at very elevated levels (*chart 3*) suggesting marginal new demand may be limited. That said, we acknowledge that with the Fed easing cycle and US elections getting closer, a strong decline in gold demand looks increasingly unlikely. As a result, we are revising our three-month projections to USD2,350 per troy ounce (vs. USD2,240 previously).

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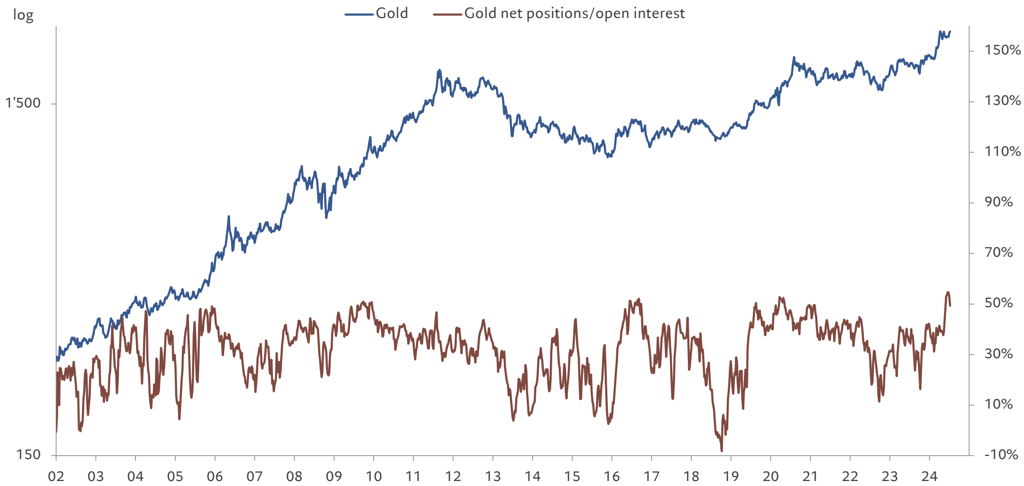
Chart 3: CFTC net long non-commercial gold positions vs. gold prices



Source: Pictet Wealth Management, LSEG, as of 16.07.2024

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