PICTET WEALTH MANAGEMENT

Precious Metals: Gold

Despite short-term price weakness, gold's long-term prospects are untarnished

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FLASH NOTE

SUMMARY

- Having risen to record nominal highs, gold prices have weakened over the past five weeks.
- We see this decline as a consequence of deteriorating investment demand because of the growing opportunity costs of owning gold and less supportive central bank demand.
- Gold prices could remain under pressure in the weeks ahead if opportunity costs keep on rising. But we continue to think a structural shift higher in official demand, together with a decline in opportunity costs and US dollar depreciation will help gold in the longer term.
- Our three-month projection for the gold price is USD2,000 and our 12-month projection is USD2,100.

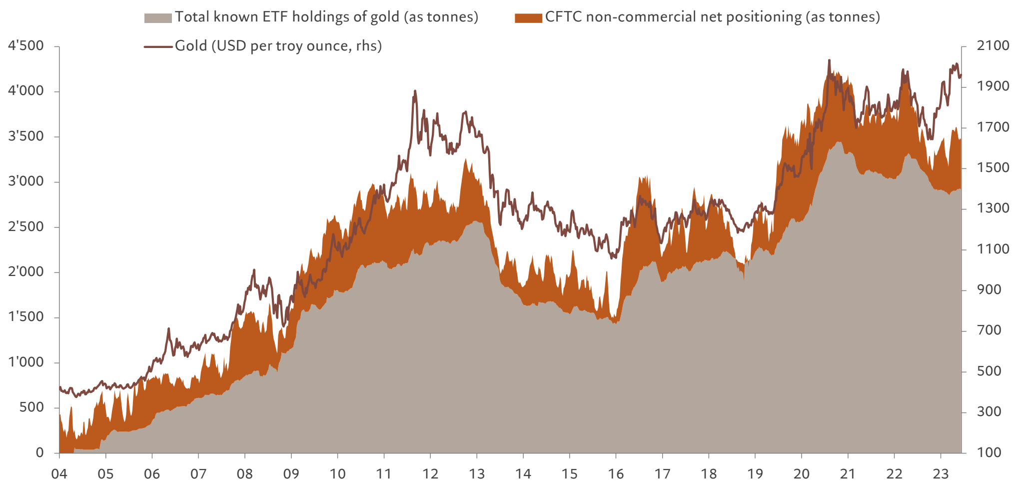
GOLD PRICES DECLINE AFTER TOUCHING PREVIOUS HIGHS

Since equalling its previous nominal record high of around USD2,070 per troy ounce on 4 May, gold prices have corrected to USD1,930 on 15 June. This decline has coincided with financial markets' upward repricing of the Fed's rate path and the resolution to the US debt ceiling issue (with both these factors helping the US dollar rebound). Higher US interest rates and a stronger dollar have led to weaker investment demand for the yellow metal.

Still, the decline in investment demand has been quite orderly thus far. In addition, most of the drop was driven by derivatives, which by nature are used by short-term investors. By contrast, longer-term ETF demand for gold has been holding up (although it did not advance much during the gold rally between November and May).

Looking forward, weakening economic activity in the US and abating inflationary pressure suggest the Fed will be more accommodative in 2024, reducing upward pressure on US interest rates and the US dollar. Furthermore, investment demand could continue to prove resilient should economic and geopolitical uncertainties remain rife.

Gold price vs. investment demand (as proxied by ETFs and derivatives demand)



Source: Pictet Wealth Management, Bloomberg Finance L.P., as of 14.06.2023

CENTRAL BANKS' DEMAND HAS DETERIORATED

According to World Gold Council data, official demand (i.e. central banks and other institutions) for gold was 228 tonnes in Q1. Although lower than in the previous two quarters, this figure still points to annual demand of close to 1,000 tonnes, well above the roughly 500 tonnes yearly average prior to 2022. Furthermore, reported central bank demand accounted for only half of the Q1 figure, suggesting that the other unreported half may still be connected to the ongoing weaponisation of FX reserves by the West.

That said, reported central bank demand has deteriorated since March. In particular, from being the main reported buyer of gold last year (148 tonnes), the Turkish central bank has recently turned into a net seller, selling potentially as much as 160 tonnes of gold between March and May. Such sales seem to have been made to satisfy domestic demand after a partial ban on gold imports was imposed following the earthquake in southern Turkey in February. As a result, these net gold sales could prove temporary (indeed partial data from June suggests that sales have been tailing off in recent weeks) and there is no indication that the Turkish central bank has definitively lost its appetite for gold reserves. Stepped-up sales by gold-producing countries anxious to cash in on high prices have also caused a ''glut' of gold on bullion markets.

CONSOLIDATION IN PRICE COULD CONTINUE

In the short term, investment demand could remain muted because of gold's increasing opportunity costs. Indeed, given limited signs of a meaningful decline in underlying inflation in many major economies, central banks may have to maintain

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an aggressive monetary stance for some time, as highlighted by current market expectations for one further Fed rate hike this year. Absent any significant decline in economic activity or inflationary pressure, high US interest rates may remain a drag on the gold price. That said, our central macro scenario is for a weakening of US economic activity in H2. Furthermore, any additional rate hike by the Fed in H2 is likely to weigh even more on the real economy, thus eventually leading to an even sharper decline in policy rates than if the Fed stays pat in H2. Overall, our assumption remains that the opportunity costs of holding gold are likely to decline in 2024 (along with the US dollar). This should help lift the gold price.

In parallel, after the measures taken against Russia, fears that the West may again use sanctions against its rivals could nurture strong official demand for gold. In other words, any decline in investment demand for gold because of opportunity costs could be partially offset by strong jewellery and official demand.

Overall, muted official and investment demand could continue to put downward pressure on the gold price over the next few weeks. But, in the longer term, geopolitical tensions, a less aggressive Fed and a weaker dollar all point to potential gains for gold. Our three-month projection for the gold price is USD2,000 and our 12-month projection is USD2,100.

Gold reserves at the central bank of the Republic of Turkey (tonnes)

Source: Pictet Wealth Management, Refinitiv, as of 14.06.2023

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