

PRECIOUS METALS: GOLD

IMPROVING MOMENTUM IN GOLD PRICE

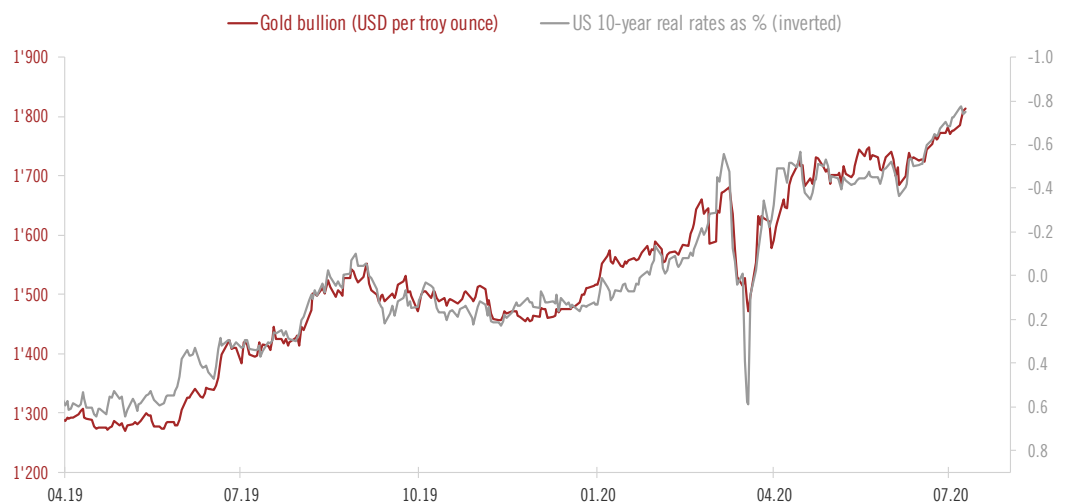
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SUMMARY

- The price of gold has made new multi-year highs as higher inflation expectations have pushed US long-term real rates to new lows.
- Given our upgrade to the outlook for oil prices, the risk of a rise in inflation expectations to pre-pandemic levels has increased.
- Using ETF purchases as a proxy, investment demand remains strong. Jewellery demand may also improve in the coming months given favourable seasonality, although gold's affordability means the rebound could be relatively weak.
- On the back of these developments, we have decided to raise our projections for gold. The three-month projection now stands at USD1,890, the six-month projection at USD1,950 and the 12-month projection at USD2,000.

CHART 1: GOLD PRICE AND US 10-YEAR REAL RATE



Lifted by US long-term real rates

After some price consolidation from mid-April to mid-June at between USD1,670 and USD1,750 per troy ounce, the gold price has recently made fresh multi-year highs. As previously explained, the gold price has been highly sensitive to US real rates in the past months. The new lows in US 10-year real rates have therefore been instrumental in gold's rise (see chart 1).

The main driver of the decline in real rates has been a rise in inflation expectations as nominal rates have been stable at around 0.7%. Following the sharp rebound in the oil price since its April lows and some recent positive economic data in the US, inflation expectations have risen, as can be seen in the breakeven inflation rate (see chart 2). While our central macro scenario foresees a slow economic recovery, the recent upgrade in our outlook for oil prices means stronger downward pressure on US real rates. The progress

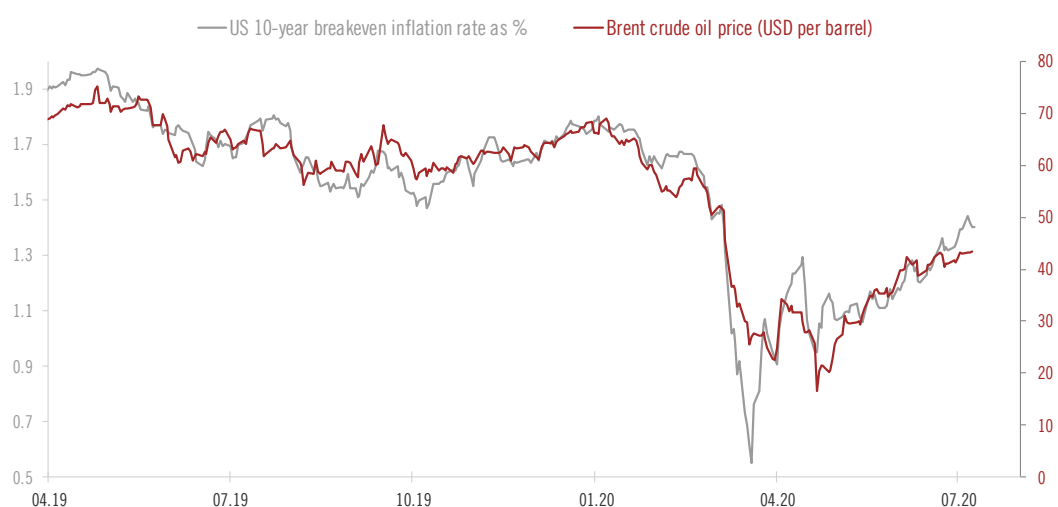
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in Modern Monetary Theory (MMT) type ideas for monetary policy also point to low real rates for some time.

That said, long-term US nominal rates are unlikely to decline much further from their current low levels (around 0.65% on 8 July). Furthermore, our central macro scenario being that inflationary pressure will remain low, the chance for inflation expectations to rise much seems limited. Still, a move back to pre-crisis expectations (around 1.65%) could lift the gold price to around USD1,900, assuming a stable nominal rate.

CHART 2: US INFLATION EXPECTATIONS VS. OIL PRICE



Source: PWM - AA&MR, Bloomberg, Refinitiv, 9 July 2020

Looking at investment demand, ETF holdings of gold continue to increase. Although there has been a decline in ETFs' monthly purchases of gold since April, they are still at high levels compared to previous years (*see chart 3*). Furthermore, using net gold positioning in the futures market as a proxy, sentiment remains firmly optimistic. It is also worth stressing that US dollar weakness cushioned the decline in gold prices from mid-May to mid-June. But gold's recent renewed strength has been broad based, with gold denominated in euros and Swiss francs closing in on new highs.

Along with real rates, other factors may support the gold price.

In particular, the massive amount of liquidity injected into financial systems by major central banks and the increase in debt piles could help gold given it carries no credit risk and has a proven track record as a store of value.

Our central scenario, which foresees a weakening of the US dollar in the next 12 months, could also push gold prices higher. Indeed, low US real rates are weighing on the overvalued US dollar while the prospect of a global economic recovery should reduce safe-haven demand for the US dollar.

Finally, the traditional seasonality of Indian and Chinese jewellery demand could help support gold prices toward the end of the year, although affordability issues could limit any rise.

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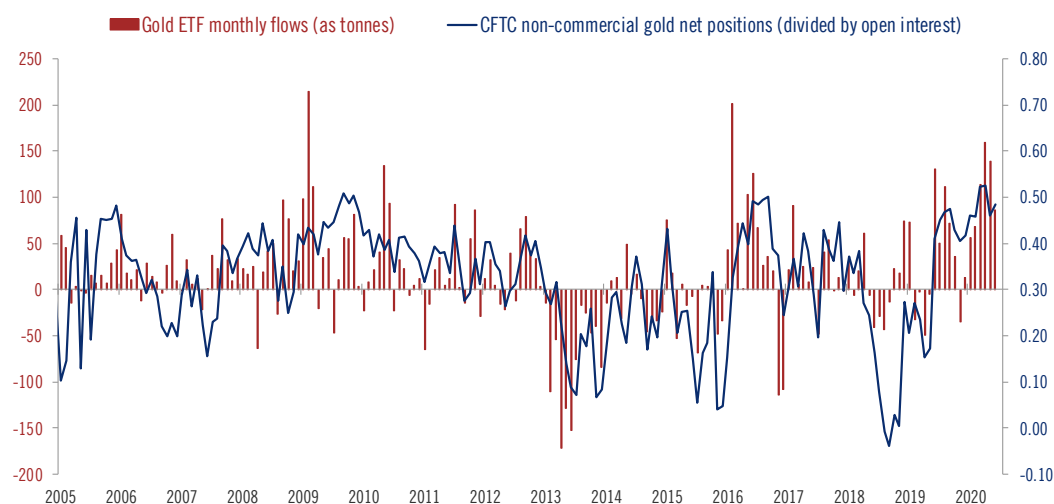
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Gold projections revised higher

Our previous short-term cautious stance on the gold price, mostly linked to real rates and the lack of other types of demand besides investment demand, is definitively being challenged by recent developments. We have decided to adjust our projections higher to reflect the current strong momentum in gold prices, the risk of a further short-term rise in inflation expectations and our own medium-term positive outlook on gold.

Our three-month projection is revised upward to USD1,890 per troy ounce (compared to USD1,670), our six-month projection is raised to USD1,950 (from USD1,780) and our 12-month projections stands now at USD2,000 (from USD1,820).

CHART 3: MONTHLY FLOWS FROM TOTAL KNOWN ETF HOLDINGS OF GOLD AND CFTC GOLD POSITIONING



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