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PRECIOUS METALS: GOLD

ROOM FOR DISAPPOINTMENT IN THE SHORT TERM

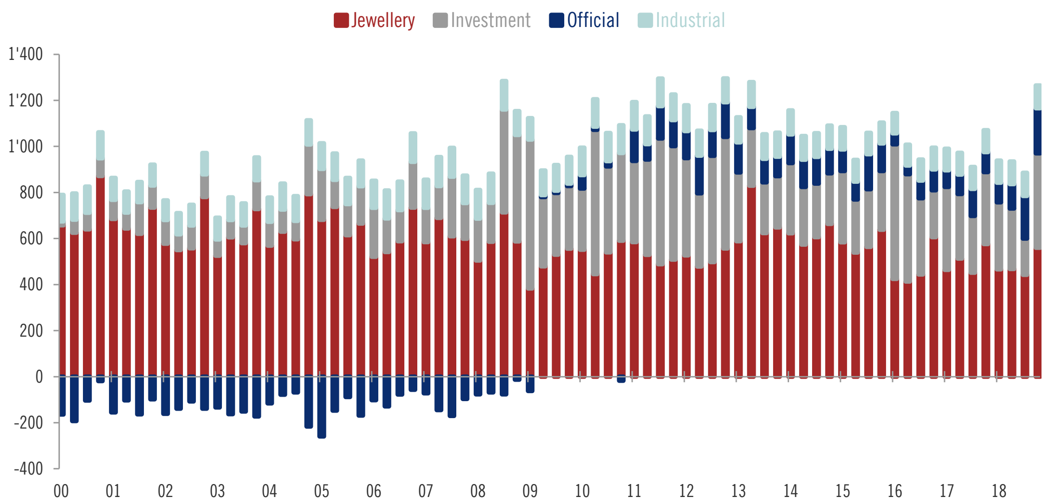
Author

LUC LUYET
lluyet@pictet.com

SUMMARY

- The fourth quarter of last year saw a strong upsurge in the gold price thanks to a sharp increase in investment demand.
- Besides seasonally strong jewellery demand in Q4, there was also a sharp increase in central bank demand last year, continuing a structural trend in place for the past decade.
- The level of investment and jewellery demand for gold seen in Q4 is unlikely to last, pointing to some moderation in gold price in the short term, especially given its recent uninterrupted appreciation. Our three and six-month projections are USD1,270 and USD1,240 per troy ounce, respectively.
- In the medium term, the moderation in global growth and the approaching end of the Fed's policy normalisation should provide tailwinds to the gold price. Our 12-month projection is USD1,280 per troy ounce.

CHART 1: GOLD DEMAND BREAKDOWN



Source: PWM - AA&MR, Thomson Reuters

Sharp pickup in gold demand in Q4 last year

Last year ended on a very strong note for gold demand, with a significant increase in jewellery and investment demand in the fourth quarter *(see chart 1)*, leading to strong price performance (7.7% in US dollar terms in Q4).

It is worth stressing that US dollar movements were not an important factor in gold's performance. Indeed, the US dollar index appreciated slightly in Q4 (c.1%) and gold also performed very well in other currencies during the same period (8.8% in euros and 7.7% in Swiss francs).

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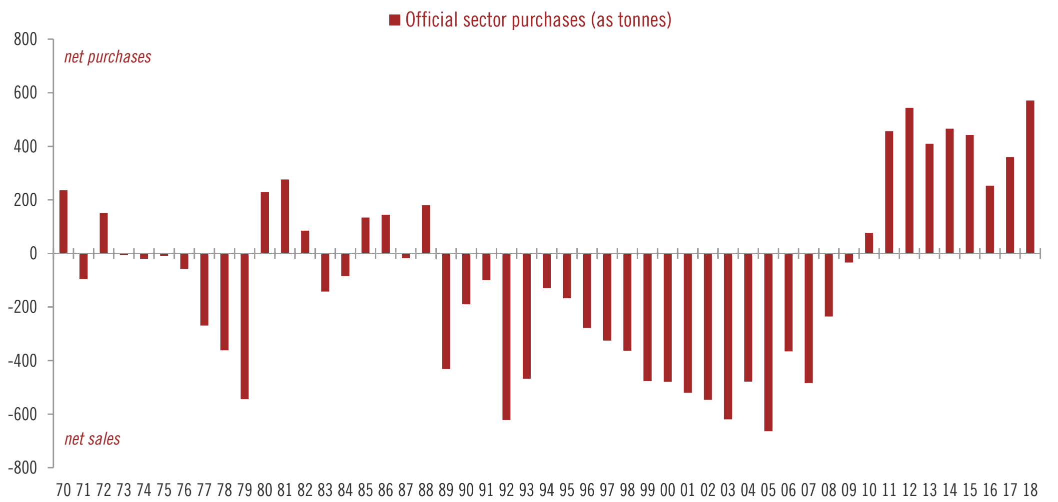
Jewellery demand is usually strong in Q4

China and India combined account for almost 60% of jewellery demand for gold. Indian festival and wedding seasons around the end of the year and the Chinese New Year tend to boost gold consumption. Historically, this has meant that jewellery demand tends to be weakest in Q1 and highest in Q4. Such seasonal factors point to a decline in jewellery demand in the current quarter.

Stock market decline has boosted safe-haven demand

Among the key drivers for the gold price is its safe-haven status. The stock market decline in 4Q 2018 (when the S&P500 dropped around 20% from peak to trough) likely boosted demand for gold. However, investors' risk appetite swiftly returned at the end of last year (the S&P500 rebounded 18% from 24 December to 15 February), which would normally mean that safe-haven demand for gold falters. Furthermore, our central scenario that a recession in the US is unlikely in 2019 and that an escalation in the trade dispute between the US and China will be avoided in the coming months points to reduced demand for gold in the short term. Finally, although a dovish Fed might cap the opportunity cost of holding gold, it should also help support the equity market. Overall, while concerns about the global growth outlook should continue to provide some tailwind to gold prices, investment demand in the next few quarters is unlikely to be as strong as in Q4 last year.

CHART 2: CENTRAL BANKS' GOLD DEMAND



Source: PWM - AA&MR, Thomson Reuters

Official demand rose sharply in the second half of 2018

Central banks significantly increased their purchases of gold last year. Indeed, central bank demand increased by more than 200 tonnes in 2018 to reach its highest level since 1971, when US dollar convertibility into gold was ended (*see chart* 2). This compares to a decline of around 70 tonnes in jewellery demand and a similar drop in investment demand in 2018. Demand was particularly strong from central banks in Russia, Turkey and Kazakhstan. High global political and economic uncertainties are likely behind this

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rise, as adding gold to official reserves tends to reduce volatility. Along with being a safe and liquid asset, gold helps diversify central banks' holdings.

To be fair, the impact of official demand on gold prices seems relatively low, historically representing roughly 10% of total demand. Furthermore, trends in official demand for gold have been negatively correlated with gold prices in the last 20 years. Indeed, central banks were heavy sellers of gold from 2000 to 2008, when gold prices were strong, but turned into heavy buyers in 2011, when a decade-long gold bull market came to an end.

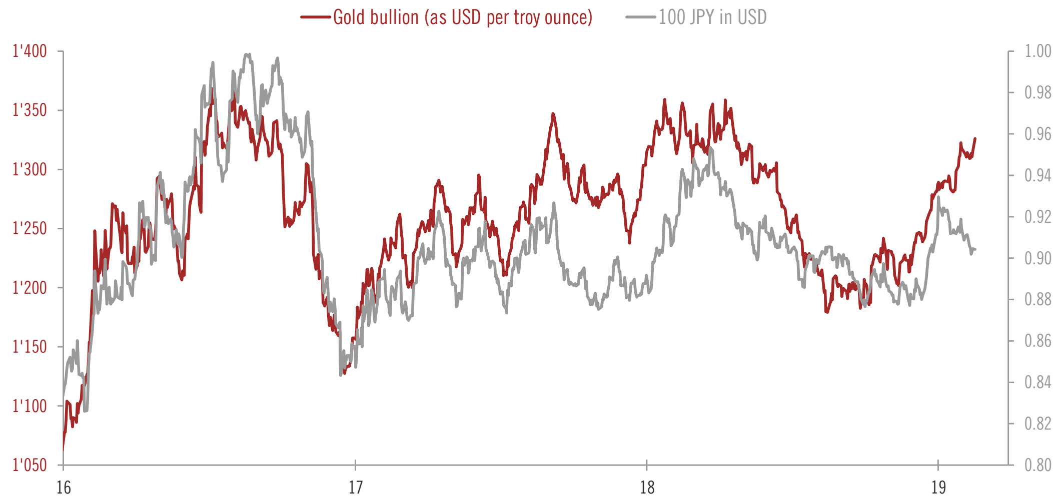
That being said, it seems likely that structural factors are at play in central bank demand. The global low-growth environment may continue to push central banks to add gold to their official reserves, especially if they want to diversify away from the US dollar (usually a large chunk of official reserves) but are also concerned about the euro's long-term prospects (for the time being, the sole credible alternative to US dollar exposure).

Gold price vulnerable in the short term

Overall, the underlying factors that boosted jewellery and investment demand late last year may not be sustained in the next few months. The gold price therefore looks vulnerable in the short term in light of the strong rise in Q4. This is particularly true given that gold looks expensive both relative to the Japanese yen (another defensive asset, *see chart 3*) and to US real rates.

We continue to see a consolidation in the gold price in the next few months, explaining our three-month projection of USD1,270 per troy ounce and our six-month projection of USD1,240. In the medium term, moderating global growth, the approaching end of Fed policy 'normalisation' and our scenario for US dollar weakening should prove supportive of investment demand for gold. As such, we would expect any near-term price weakness to be temporary before another leg higher. Our 12-month forecast for gold stands at USD1,280 per troy ounce.

CHART 3: GOLD PRICE VS. JAPANESE YEN



Source: PWM - AA&MR, Thomson Reuters

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