PRECIOUS METALS: GOLD

BAD NEWS IS GOOD NEWS FOR GOLD

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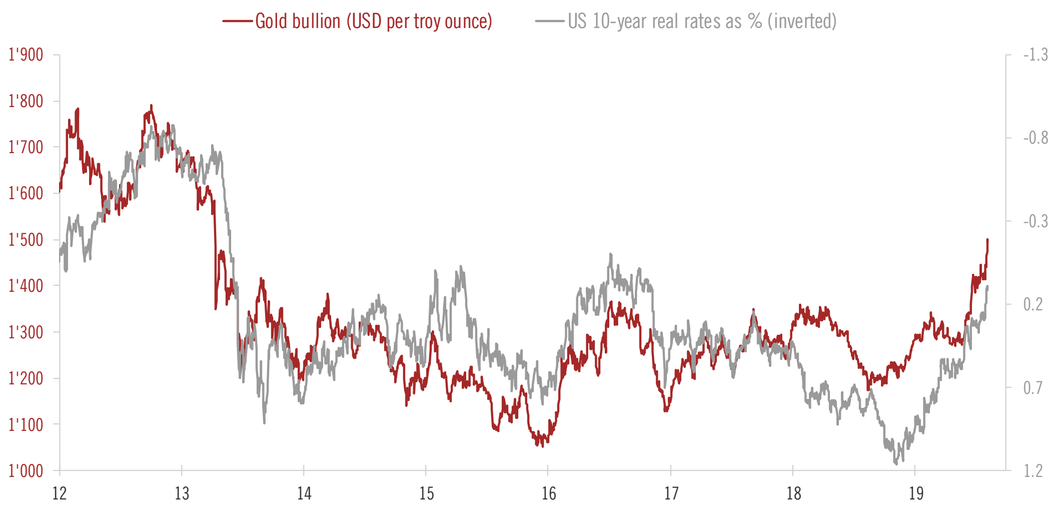
SUMMARY

- The increase in trade tensions following Trump's threat of additional tariffs on Chinese goods on 1 August has boosted the gold price above USD1500 per troy ounce.
- The recent developments are supportive of gold investment demand because of a lower opportunity cost of holding gold and greater demand for safe havens. Coupled with strong demand from central banks, the medium-term outlook of the yellow metal has improved.
- However, in the short term, we see a high probability of a mild correction because the recent sharp rise in gold may suffer from less supportive news flows than of recent days.
- Specifically, we favour a gold price of USD1440 on a three-month time horizon and USD1600 on a 12-month horizon.

CHART 1: GOLD PRICE VS. US 10-YEAR REAL RATES



Source: PWM - AA&MR, Bloomberg, 8 August 2019

Gold boosted by increasing trade tensions

The surprise escalation in trade tensions on 1 August, when Trump threatened China with new tariffs on its exports to the US have been supportive of gold. The yellow metal rose from USD1413 per troy ounce on 31 July to as high as USD1510 on 7 August, a nearly 7% price increase.

This development has led us to amend our scenario on gold. Indeed, prior to 1 August, we favoured a significant short-term correction in price as investment demand for gold was only supported by the decline in rates (reducing, on a relative basis, the opportunity cost of holding non-yielding gold). The US dollar was quite stable at elevated levels (reducing the attractiveness of gold as a hedge against dollar depreciation) and global risk appetite was resilient, highlighted by the new highs in the US stock market in July (weighing on safe-haven demand).

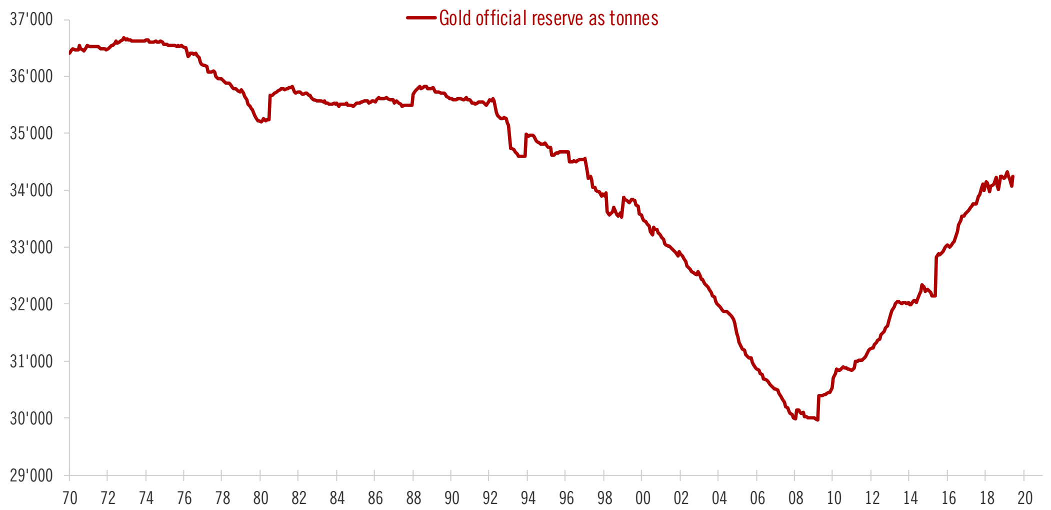
However, the threat of additional tariffs on China followed by the renminbi weakening below the highly watched CNY7.00 per USD threshold and the subsequent US official labelling of China as a currency manipulator make a trade agreement less likely (see here). Furthermore, the increasing trade tensions and higher uncertainty related to renminbi behaviour have weighed on global risk appetite. As such, the outlook for safe-haven demand for gold has improved.

Jewellery and official demand supportive of gold

The strong performance in gold was mirrored, to a lesser extent, by defensive currencies such as the Swiss franc and the Japanese yen, which are sensitive to the same factors. However, while central banks can intervene to constrain currency appreciation (e.g. the Swiss National Bank has likely resumed its FX intervention as at the end of July), gold is supported by a structural increase in net central bank purchases (official demand represents a bit more than 10%), notably when seeking an alternative to the US dollar (*see chart 2*).

Furthermore, jewellery demand, while price sensitive, tends to improve around the end of the year, because of the seasonal pattern of Chinese and Indian demand (representing roughly half of total jewellery demand). Consequently, jewellery demand could prove supportive of the gold price in the next months. That being said, given the usual lower quarterly variations in jewellery demand compared to investment demand (which represents slightly less than 30% of total demand) and the current high price of gold, jewellery demand is likely to act only as a mildly supportive factor.

CHART 2: OFFICIAL RESERVES IN GOLD



Source: PWM - AA&MR, Refinitiv, 8 August 2019

Forecasts revised higher but short-term cautious

While we acknowledge that we were too cautious tactically on gold in July, **we do not see the current gold price as particularly attractive on a short-term basis**. Obviously, the

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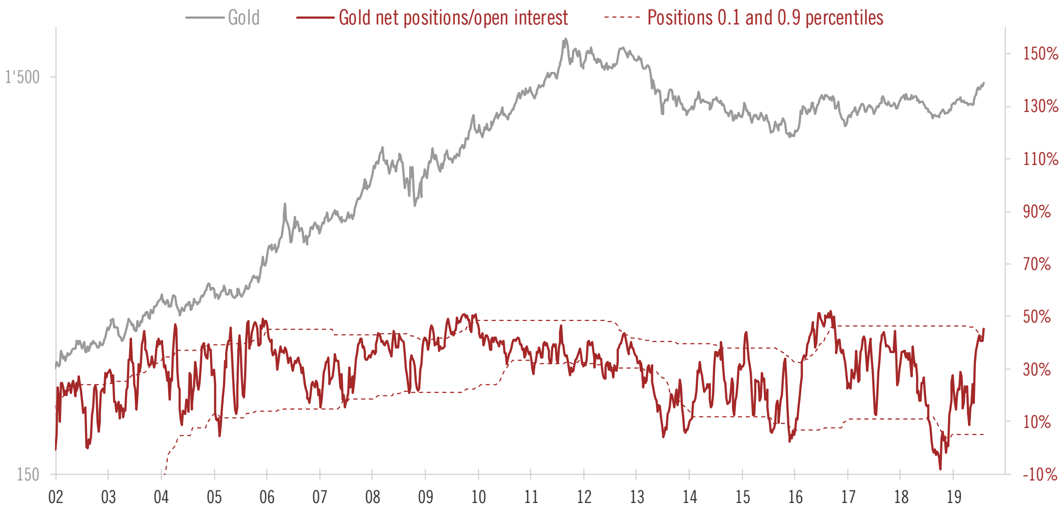
price of gold has risen sharply in a short amount of time. Furthermore, market expectations are already discounting very accommodative major central banks in September. We also expect some stabilisation in terms of trade tensions (renminbi should not significantly depreciate (see here) and the US may refrain from imposing additional tariffs, after the likely implementation of the new tariffs on 1 September). In terms of risk appetite, the recent stock market correction roughly mirrored in magnitude the previous correction in May, which was notably triggered by Trump's announcement of a rise in tariffs from 10% to 25% on USD 200bn of Chinese goods. Finally, market sentiment is extremely positive on gold, as confirmed by the extreme net long gold positioning among speculative investors (*see chart 3*).

In the medium term, rising trade tensions are likely to weigh further on global growth and elicit more accommodative monetary policy from central banks. Coupled with strong official demand, elevated global uncertainties and a mature US business cycle, **we favour more upside for gold on a 12-month time horizon from current levels** (USD1500 on 8 August). In a nutshell, as the number of positive-yielding bonds falls, the rationale for holding a liquid safe haven asset such as gold rises.

In light of the recent developments, we have decided to increase our projections for the gold price. We favour a gold price of USD1440 on a three-month time horizon (versus USD1320 previously), USD1500 on a six-month time horizon (versus USD1380 previously) and USD1600 on a 12-month time horizon (versus USD1480 previously).

CHART 3: CFTC NON-COMMERCIAL GOLD NET POSITIONS (DIVIDED BY OPEN INTEREST)



Source: PWM - AA&MR, Refinitiv, 8 August 2019

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