

Commodities Strategy

Raising Our Gold Forecast Further To USD1,650 /oz

Tuesday, 13 August 2019

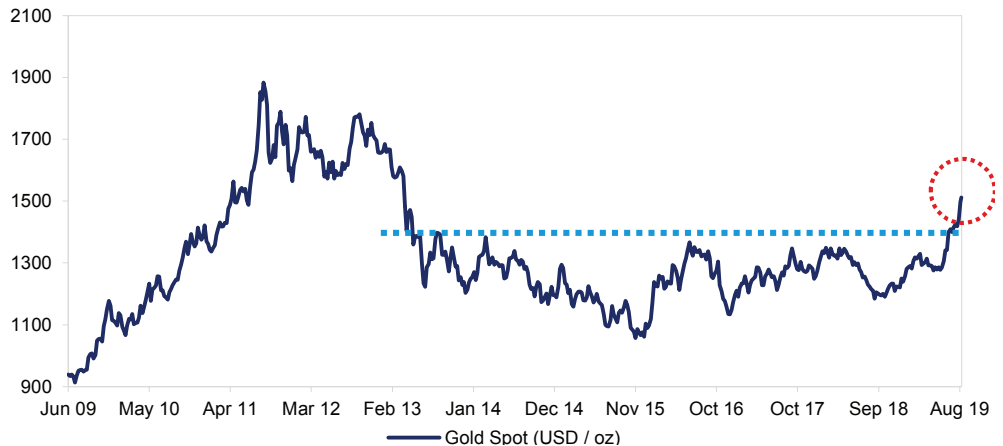
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- The recent strong rally in gold has lifted the price above our 2Q20 target of USD 1,500 / oz. As the various positive drivers for gold are set to remain rather compelling, we raise our positive gold forecast further to USD 1,650 / oz for 2Q20.
- In addition, we note that the strong rally in gold has also lifted the Gold vs Silver Price Ratio to a significantly high level, implying that silver may well pay catch up to gold strength.

A day after the 20th June FOMC, gold traded above the key psychological headline resistance of USD 1,400 / oz. That was when 10 year US Treasuries yield fell below 2% after FED Chairman Jerome Powell sounded unmistakably dovish, signaling an imminent rate cut at the 31st Jul FOMC (which subsequently came to pass in the Jul FOMC). Since then, in just barely 2 months, gold has rallied further to trade above our 2Q20 target of USD 1,500 / oz. At the moment of writing, gold is currently trading at USD 1,515 / oz.

Chart 1: Gold Rallies Further Above USD 1,500 /oz

Source: Bloomberg, UOB Global Economics & Markets Research



The Growing List Of Positive Drivers For Gold

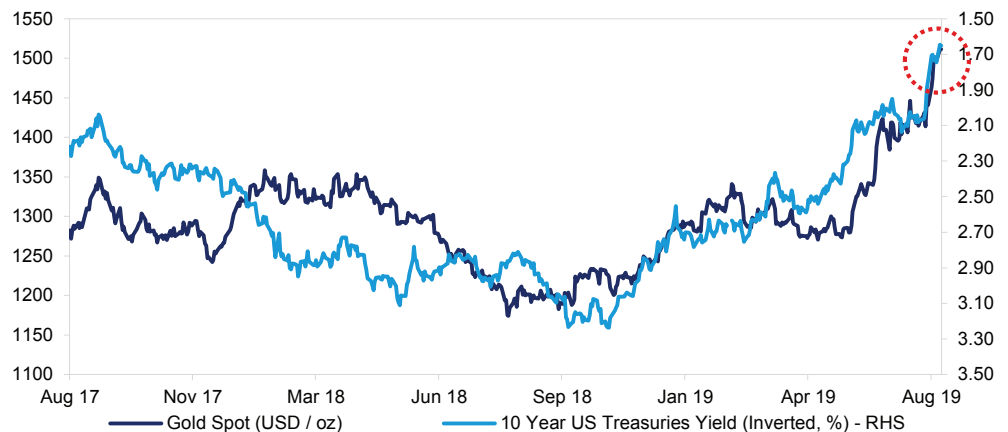
By now the list of strong positive drivers for gold is apparent

1. Global central banks have reverted to a synchronized monetary easing cycle, dropping rates en masse. The US Federal Reserve's 25 bps cut on 31 Jul opened the door for various Asian central banks to follow suit. In the days that followed, Reserve Bank of India (RBI), Bank of Thailand (BoT) and Bangko Sentral ng Pilipinas (BSP) all dropped their benchmark rates. Last Wednesday (7 Aug), Reserve Bank of New Zealand (RBNZ) even surprised with an outsized 50 bps rate cut. In mid-September, the European Central Bank is also widely expected to follow up with some form of monetary policy easing as well. These rate cuts lower the funding cost for maintaining a long position in gold and are a very strong supportive factor for gold.

2. Concurrently with the renewed global synchronized monetary easing cycle, global bond yields have fallen back sharply. As 10 year US Treasuries yield fell from 2% to 1.6%, key Eurozone benchmark yields all went further into subzero. The 10 year French OAT yield now trades at -28 bps as 10 year German Bund yield plunged to -59 bps. Lower long term yield is also a strong supportive factor for gold.

Chart 2: Gold Takes Off Alongside The Slump In US Treasuries Yield

Source: Bloomberg, UOB Global Economics & Markets Research



3. Safe haven demand for gold surged on global growth slowdown fears and escalation of various geopolitical uncertainties. At the risk of sounding like an overt pessimist, the list of global worries has increased significantly over the past month. These include on-going skirmishes with Iran in the Middle East, renewed missile tests by North Korea, increasing risk of a disruptive “No Deal” Brexit for the UK under Prime Minister Boris Johnson and escalating US-China trade tensions (arguably the most critical known unknown). As a result, safe haven demand has surged, leading to strength in traditional safe haven assets like gold, JPY and CHF.
4. Local currency depreciation adds to gold’s long term demand as a store of value. With the further escalation of US-China trade conflict, the Chinese Yuan (CNY) has now fallen past 7.0 against the USD to 7.05. Concurrently, the Indian Rupee (INR) has also fallen back to the weaker side of 70. And just overnight, the Argentinian Peso (ARS) plunged from 45 to 53 against the USD on rising risk of default after incumbent President Mauricio Marci’s significant loss in the primary elections. This series of local currency depreciation magnifies the value of gold and fuel’s the traditional role of gold as a store of value. For example, because of INR weakness, gold in INR terms just popped above the psychological 100,000 level. Over the past 10 years, as the INR depreciated, gold in INR terms has rallied 130%, significantly in excess of gold’s rally in USD terms of 60%.

But Long Positioning In Gold Is Increasingly Crowded

However, it is worth noting that further strength in gold is not without risk. This is because both key positioning measurements for gold now appear crowded. The net long positioning for gold on the CFTC as implied from futures position is now near the historical peak yet again, while the total ETF holdings for gold has increased significantly over the past 3 years and is now targeting the previous peak last seen in late 2012.

Chart 3: CFTC Net Non-Commercial Futures Positioning In Gold Is Now Near Record High

Source: Bloomberg, UOB Global Economics & Markets Research

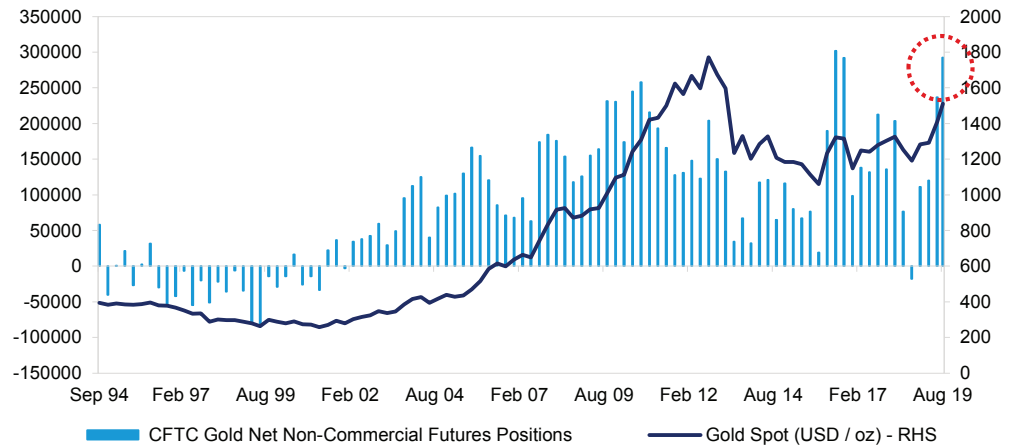
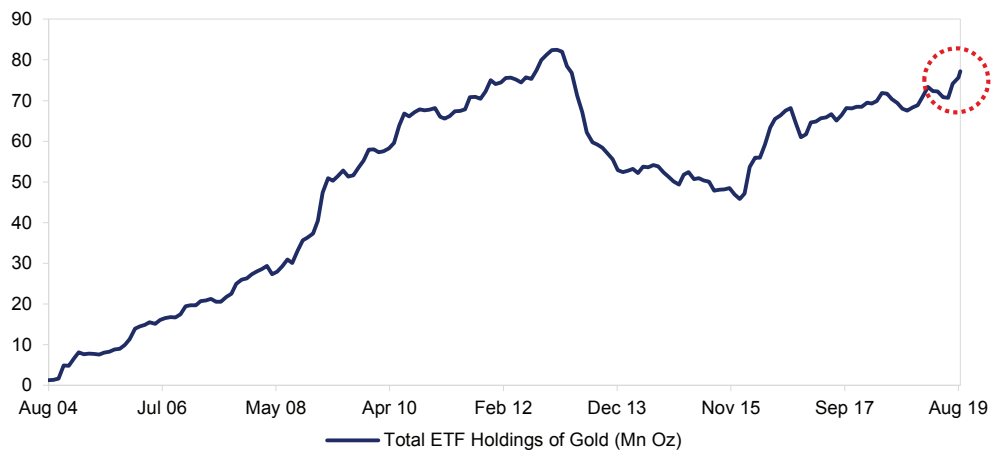


Chart 4: ETF Holdings In Gold Target Previous Peak In Late 2012

Source: Bloomberg, UOB Global Economics & Markets Research



Overall, We Raise Our Gold Forecast Further To USD 1,650 / oz By 2Q20

Since the start of the year, we have progressively raised our positive gold forecast. In our 2Q19 Quarterly Report published on 22 Mar 19, we noted that [“Gold: Set To Rally Further As FED Signals End To Rate Hiking Cycle”](#) and forecasted that gold will target USD 1,450 by 1Q20. Thereafter, in our 3Q19 Quarterly Report published 21 Jun 19, we reiterated that [“Gold Outperforms In A Difficult Macro Environment For Commodities”](#) and raised our forecast further to USD 1,500 / oz by 2Q20.

Given that gold has now traded above our USD 1,500 / oz target and the above-mentioned positive drivers remain compelling, we raise our forecast further. We now expect gold to target USD 1,550 / oz across 3Q19, USD 1,590 / oz by 4Q19, USD 1,620 / oz by 1Q20 and USD 1,650 / oz by 2Q20.

Is Silver Going To Play Catch Up To Gold?

So far, silver remains the gold's poorer cousin and it is not difficult to see why silver has lagged gold's latest advance. Silver is held back by weak industrial demand as well as significantly lower investment demand from ETFs and various financial assets.

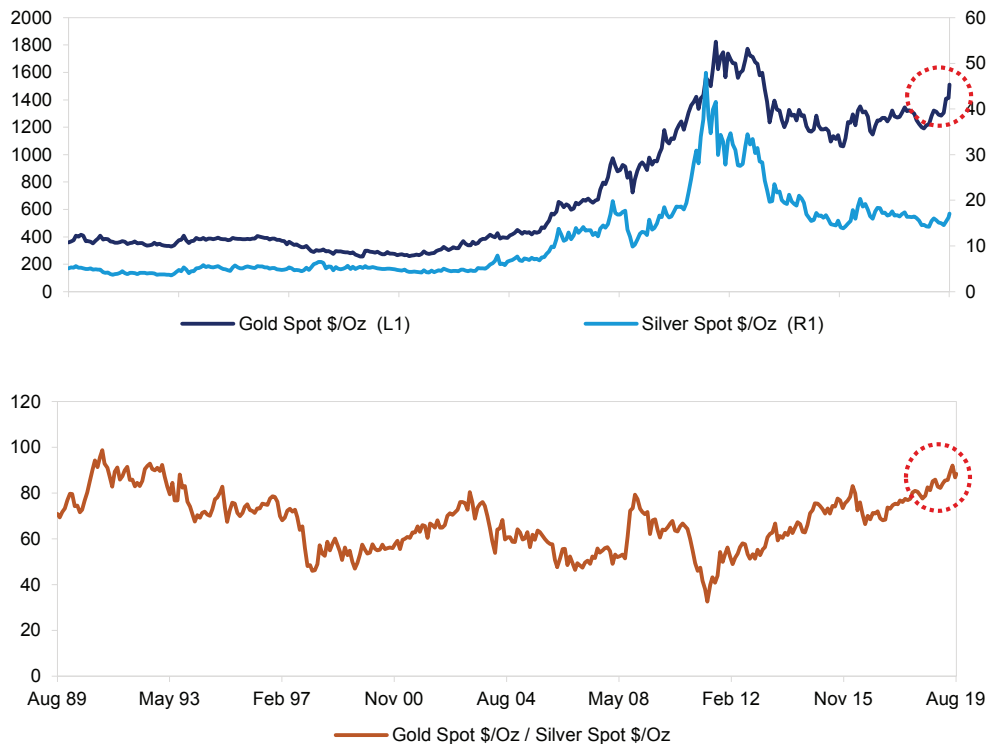
In addition, silver also suffers from lower liquidity. However, this lower liquidity is a double edged sword and may be a strong positive driver should safe haven demand decide to diversify from gold to silver. Over the past few decades, global investors have noticed that because of this lower liquidity, silver could easily play catch up to gold strength and in rather explosive moves.

A favorite metric employed by silver bulls is the Gold vs Silver Ratio. Since bottoming out around 35 in mid-2011 during the previous precious metal rally, this Gold vs Silver Ratio has risen significantly to the current level of under 90. Silver bulls will suggest that the time is ripe for silver to play catch up with gold because this price ratio is now too high.

Objectively, price ratios are but a mere mathematical ratio, and unlike a macroeconomic indicator one cannot judge whether a price ratio is too high or too low. More importantly, price ratios can stay at extreme low or high for extended period of time. Historically, gold has also tended to outperform silver during periods of heightened market fears. To wit, during the end July to August's VIX spike from 12.2 to around 24.6, the gold/silver ratio rose (i.e. gold outperform silver) from 86.3 to 89.7. Nonetheless, if gold price rallies further as we anticipate, it may well pull silver price higher as well, effectively leading to the retreat of the Gold versus Silver Ratio.

Chart 5: Silver To Play Catch Up With Gold's Rally ?

Source: Bloomberg, UOB Global Economics & Markets Research



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