26 July 2024

FX Viewpoint

Currencies
Global

Gold: High, but not sustainably higher

- Gold prices are likely to remain high until US elections…
- …but building a sustained rally above USD2,400 per ounce seems difficult, amid positive US real rates and a strong USD
- High gold prices limit demand but encourages supply

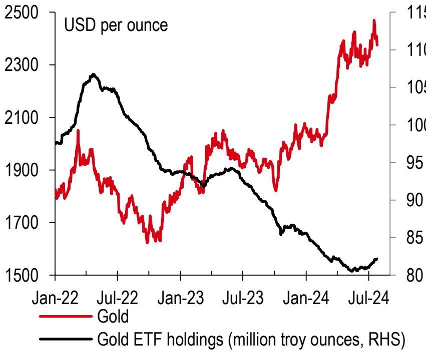
In our precious metals analyst's view, gold prices are likely to remain high until US elections

High gold prices have been limiting key demand and gold ETF liquidation could resume

Ongoing geopolitical risks have significantly bolstered the 'safe haven' demand for gold, with **US elections** possibly keeping the risk thermometer high. When the election outcomes are known, any **renewed focus on fiscal deficits** and rising debt-to-GDP ratios in the US and other economies could also be supportive for gold.

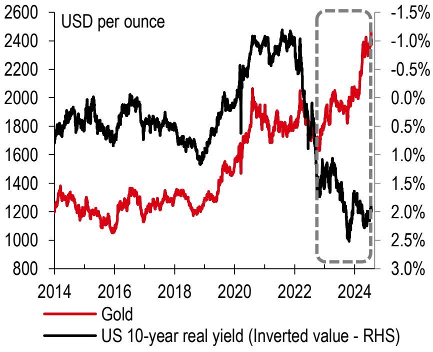
However, the recent drop in gold prices underscores the difficulty of a sustained rally above USD2,400 per ounce. Indeed, high gold prices have been encouraging greater supply (via mine output and recycling) and weighing on demand. Indeed, global demand for gold bars & coins and jewellery looks sluggish, with the major exception of **India in the wake of a reduction in customs duty on gold from 15% to 6%** (effective 24 July 2024). Central bank demand may remain historically high but is set to moderate in the face of high gold prices. Gold exchange-traded funds (ETF) holdings had also been declining since April 2022, but have started to accumulate as of late (Chart 1), probably reflecting modest portfolio diversification demand amid potential rate cuts in 2H24 and ongoing geopolitical risks. That being said, **further equity declines, if considerable, could trigger gold ETF liquidation**, in our precious metals analyst's view.

1. Gold ETF holdings started to pick up as of late, but may decline again



Source: Bloomberg, HSBC

2. The relationship between US real yields and gold may be restored



Source: Bloomberg, HSBC

With rate cuts in the price, gold may not benefit much when expectations become reality

Rate cuts are generally gold-positive, but markets have already priced in quite a lot of easing by the Federal Reserve (Fed) and other central banks. Specifically, **a 25bp rate cut by the Fed at its 17-18 September meeting is fully priced in** (*Bloomberg*, 25 July 2024). As such, our precious metals analyst thinks that the near-term boost to gold prices from this channel may be limited.

Positive US real rates and a strong USD could curb the gold rally

It is also worth noting that **gold is historically sensitive to US real rates**, and while there has been a notable disconnect in this relationship (Chart 2), positive US real rates could be a headwind for gold towards the end of 2024 and 2025, in our precious metals analyst's view. **Another headwind could come from a strong USD**. (see, "*FX Viewpoint - USD: Not struck out*" 19 July 2024 for our USD view). Although a strong USD has not measurably weakened gold prices so far this year, our precious metals analyst thinks that it may create headwinds to gold rallies.

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