GOLD INC

Commodity outlook: Gold

Recommendation: BUY

January 2023

Researched by:
Nadya, Edward
Brandon

Key Highlights

Gold price responds to hawkish interest rates

Across the year of 2022, the US Federal Reserve raised interest rate 7 times with the most recent increment happening on 14 December 2022. The Federal Reserves raised the interest rate by a half-point to a range of 4.25 per cent to 4.5 per cent, its highest level in 15 years.

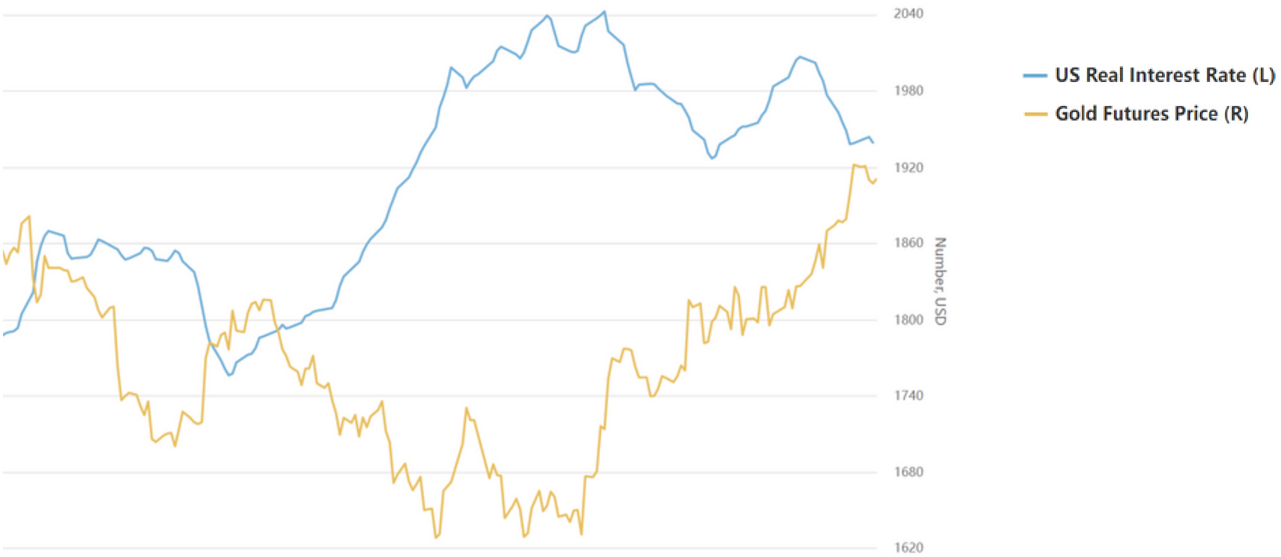
Figure 1.1 Fed Funds Rate hikes

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
Dec 14, 2022	+50	4.25% to 4.50%
Nov 2, 2022	+75	3.75% to 4.00%
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.5%
June 16, 2022	+75	1.5% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

Source: Forbes Advisor

Theoretically, gold and interest rates have a negative correlation. Since gold does not generate any yield or distribution, rising interest rates will cause financial instruments like shares and sovereign bonds to become more attractive.

Figure 1.2 Gold price's inverse relationship with interest rates (yearly chart)

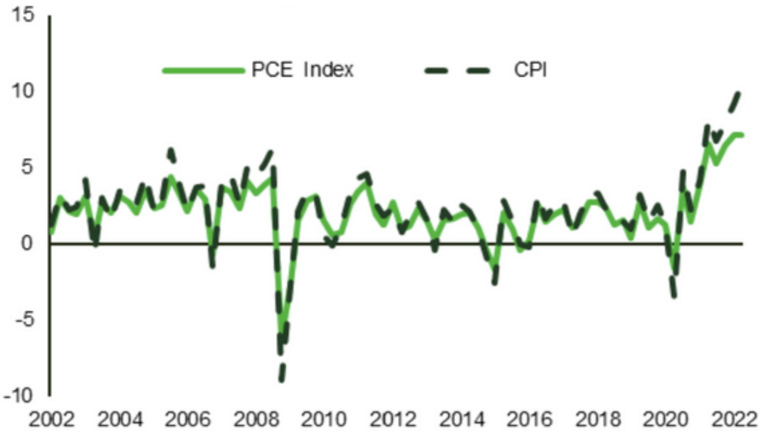


Source: Forbes Advisor

Inflation has reached its highest

Inflation has been a key indicator that reflects on the overall economic health, many metrics have been used to measure inflation namely Consumer Price Index (CPI) and Personal Consumption Expenditure Price Index (PCE). Both measure costs for consumer goods and services but CPI inflation is usually released earlier and is higher than PCE inflation. Historically, the two measures of inflation seldom deviate by large margins until in the second quarter of 2022, the quarter-over-quarter (q-o-q) change in CPI was a full 3.4 percentage-points above the same period change in PCE.

Figure 1.3 CPI inflation outpacing PCE inflation higher than usual (Q-o-q% change)



Source: MacroMicro charts

However, the recent CPIs (from January to November 2022) presented that inflation rates are slowing down. Nevertheless, the current inflationary level of 7% is still concerning the Feds and they are still working towards a 2% rate. Switzerland central banks have also lifted their interest rates by 50 basis points. This shows that the inflationary pressure is still dominating the economy and central banks are still trying to counter this further spread of inflation.

Strengthening of the US dollar

As a result of the surging US dollar strength, the LBMA (London Bullion Market Association) gold price PM (US$/oz) fell by 8% during the third quarter of 2022. The Fed has adopted a hawkish monetary policy to hike interest rates to combat high inflation rates. The average gold price was 3% lower y-o-y, closely aligning with Q3's demand and supply performance.

Figure 1.4 Gold prices inversely related to the US dollar

Source: Bloomberg, US Global Investors

Geopolitical flare-ups support hedge demand

In 2023, current geopolitical tensions surrounding the market continue to support gold as a valuable tail risk hedge. Geopolitical and economic uncertainty is mounting around the globe as it follows up on Russia's military offensive against Ukraine, with rising inflation rates since 2020 due to higher commodity prices and supply chain disruptions. This conflict further undermines the existing model of global trade and capital integration, emphasising geo-politics as an indication of economic and financial risk.

China opens up its borders since zero-covid policy

There has been increasing positive prospects towards China's reopening on January 8 (2023) after its huge adverse impact of its full lockdowns on the global economic GDP, especially with it being one of the largest country consumers. Investors predict a release of pent-up demand for commodities and authorities are planning to meet this surge in consumption and revive its economy in areas of investment such as jewellery as well as gold bars and coins. Customer demand sentiment leans more on the upside with upcoming seasonality opportunities such as the Lunar New Year celebration in February.

Gold ETF holdings face a huge sell-off

Physical-backed gold ETFs, including the US-listed SPDR® Gold Trust and iShares Gold Trust. saw a total net outflow of US$3bn, equivalent to a decline in holdings of 110 tonnes (-3% y-o-y). Gold ETFs registered their eighth consecutive month of negative demand on December at -4 tonnes month-on-month (m-o-m). This can signal speculation in market as ETFs are designed to reflect on gold prices, which encourages short positions in gold futures.

Figure 1.5 Gold ETF flows

Region	AUM (bn)	Fund Flows (US$mn)	Holdings (tonnes)	Demand (tonnes)
North America	100.6	531.7	1,727.1	8.8
Europe	91.2	-1,091.4	1,565.9	-13.8
Asia	7.3	44.7	118.7	0.8
Other	3.5	-19.5	60.8	-0.2
Total	**202.7**	**-534.5**	**3,472.5**	**-4.5**
Global inflows		**3,125.8**		**26.7**
Global outflows		**-3,660.3**		**-31.2**

Source: Goldhub

MACROECONOMIC IMPLICATIONS ON GOLD

Beginning the first quarter of 2023, gold commodities have gradually recovered in terms of market demand, especially following the ease of covid-related restrictions and China's reopening. Demand for gold increases generally in forms of hedge investments, consumer goods and currency in trading. According to our analysis, these following fundamentals are relevant factors that affect gold at the moment:

1. Economic life cycle opportunities
2. Central banks gold purchases
3. Impact from Russia and Ukraine's war
4. Supply chain crisis
5. Supply and Demand

These factors are greatly influenced by interest and inflation rates, the value of the US dollar, demand for safe-haven investments, political disputes and the follow-up of overall consumer and business confidence. These are highlighted as leading indicators to confirm the expectations for gold prices.

Gold price: at the moment

As of now, gold prices have been rallying up along with inflation rates, supported by the pullback in bond yields, and slowly recovering towards its last high level of US$2,052.

Figure 2.1 Gold spot prices

Source: GoldHub

1. Buy and Sell: Economic Life Cycle Opportunities

Recession triggers gold buys

In a global case of high inflation, gold prices follow a positive pattern upwards during periods of economic uncertainty and possible recession. Although the inflation rate factor does not directly affect the direction of gold prices, it is often how the market responds to a potential economic downturn and then it considers to diversify their portfolio risks with hedge investments in hopes of accumulating the smaller portion of losses. Gold is usually one of the sought-out options for protection during stages of stagflation or recession.

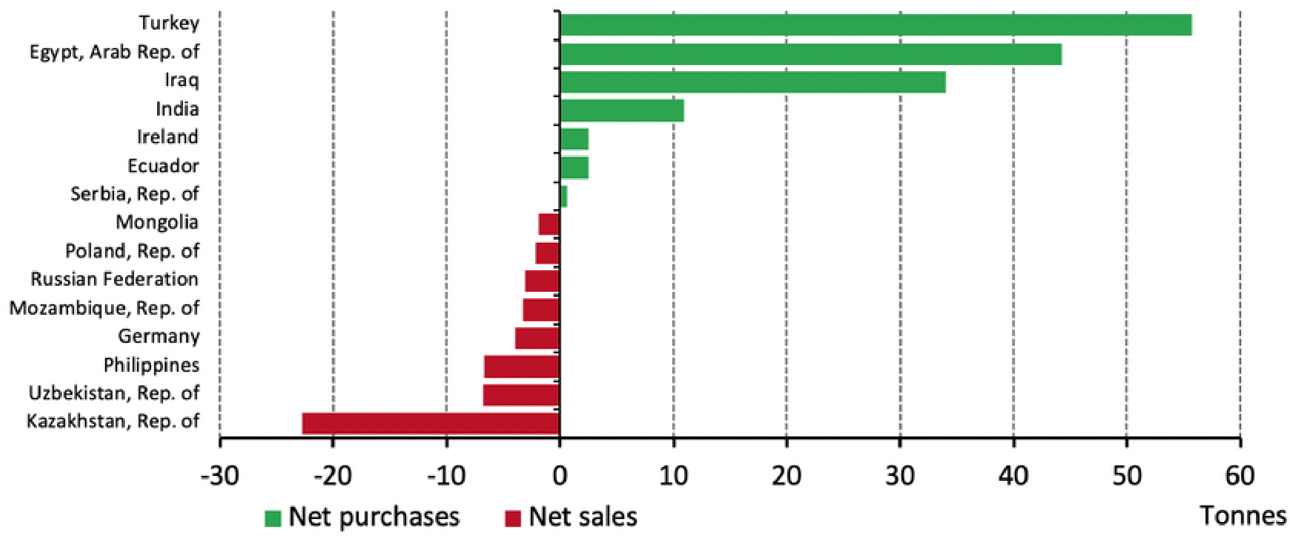
Soft landing pressures gold prices down

Differing from a hard landing recession, gold prices lose momentum as the global economy begins to recover through easing monetary policies and investors take their chances back in the stock market. Despite that economic growth is still at a slow pace, as long as there are possibilities of foreseeing a ‘goldilocks’ stage, the greater portion of the market will likely seek out other higher yield opportunities.

2. Central banks stockpiling on gold

In Q3 2022, central banks hit an all-time quarterly record buying of 399.3 tonnes (+115% q-o-q). Turkey, the quarter’s biggest buyer, added its gold reserves by 31t while the Central Bank of Uzbekistan bought another 26t in its second consecutive year and the Qatar Central Bank added 15t to its gold reserves making these countries the largest buyers of the quarter. The net demand also includes a substantial estimate for unreported purchases due to the circumstances where not all official institutions publicly report their gold holdings, especially since there has been speculation that China is holding more gold than it officially reveals . In addition to this record gold buying, central banks globally added another 31t to the official reserves in October, according to the World Gold Council.

Figure 2.2 Central banks' global purchases on gold



Source: World Gold Council

Generally, in times of uncertainty, gold is perceived as a safe-haven investment to hedge against volatile interest rates and high inflation. Primarily driven by the possibility that the Fed plans to increase its interest rates again in 2023 and the ongoing global tensions, the sentiment for gold demand will likely see an upside.

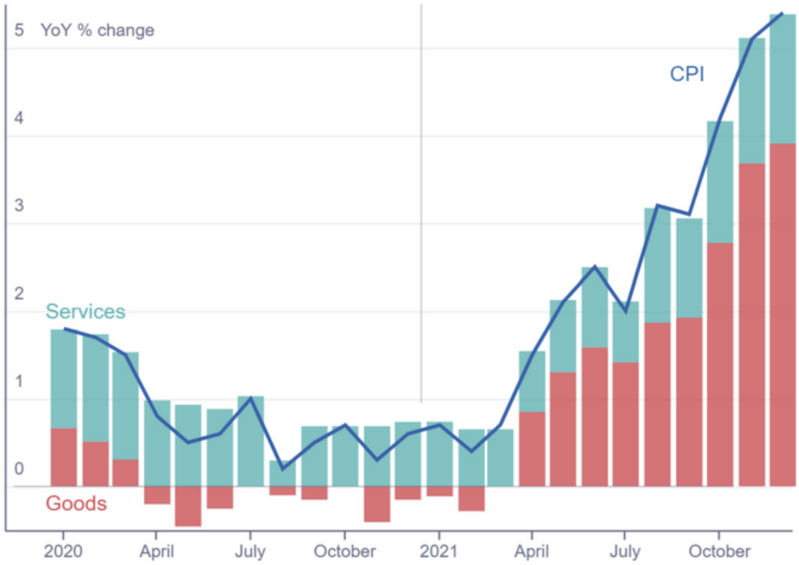
3. Russia and Ukraine: the war continues

While the following macro factors form the basis for much of the impact on gold, geo-political flare-ups could lend support to gold investments, as we see war conflicts between Russia and Ukraine in Q1 2022 . Gold is being regarded as a safe haven in times of uncertainty. We can attribute a large proportion of gold's resilience in 2022 to a geopolitical risk premium, with gold's return not fully explained by its historically important drivers.

4. Supply chain crisis

As a result of the pandemic, cut-off gaps with key suppliers and labour shortages have been contributing factors of inflation. The market has experienced a shortage of high-quality computer chips and oil as suppliers, especially in Russia, are facing major production delays while demand surges. Other affected production sectors are also facing an increase in costs, which fuels up price inflation. In the midst of the supply chain crisis, we'll likely see more safe-haven flows into gold as a way for investors to hedge their investment portfolios against persistent global supply chain issues and price inflation.

Figure 2.3 Effects of supply chain disruptions on CPI



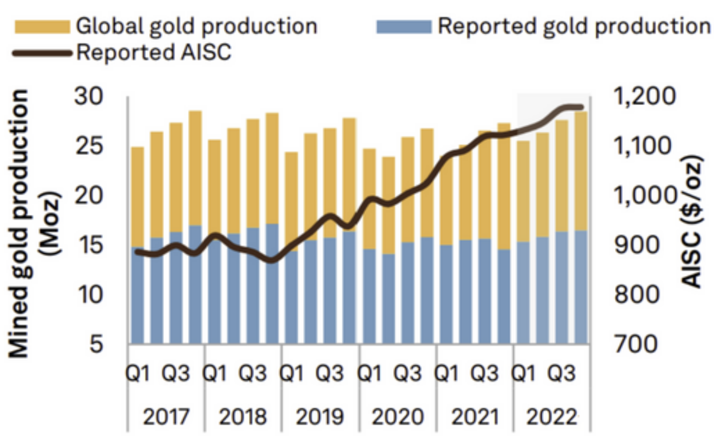
Source: Economics Observatory

6. Supply and Demand

Supply: Mined gold production forecast to rise

In response to gold demand pressures in certain global areas such as China and India, gold supply will be expected to meet market needs. The gold price outlook in 2023 reflects on the increase in gold value as a response to the supporting macroeconomic factors in the prior year, which will support gold mining companies in gaining healthy margins. We can expect gold prices to increase based on current geopolitical and macroeconomic uncertainties.

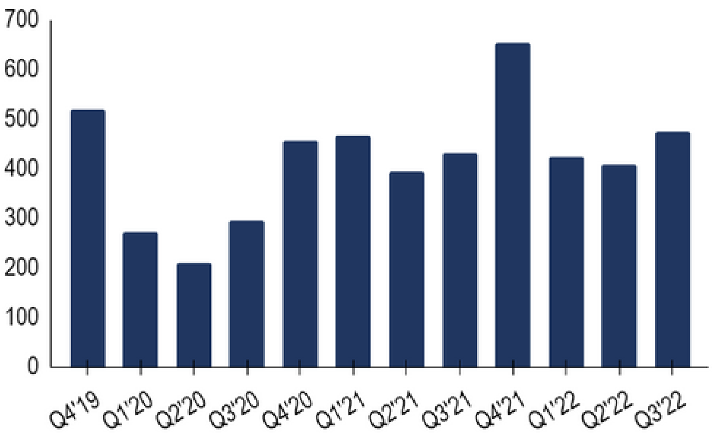
Figure 2.4 Mined gold production throughout 2022 supported by strong gold prices



Source: World Gold Council

Demand: Jewellery demand returns to pre-pandemic levels

Figure 2.5 Jewellery demand (tonnes) growing steadily since pandemic



Source: World Gold Council

Top markets: India and China

Over the decades, gold jewellery remains accountable for at least 50% of total gold demand and gold imports were mainly driven by the jewellery industry. India and China are currently the largest jewellery markets, both countries' demand amount to 50% of global total, whereas the Asian and Middle Eastern markets are dominating the demand for purer, high-carat gold. In reference to the World Gold Council's (WGC) quarterly report, the demand in India during the September quarter of 2022 grew by 17% y-o-y (146t) and took y-t-d demand to 381t, which is a 10% raise from last year's performance and nearly equivalent to 2019 pre-covid levels. These figures are followed by China's modest 5% y-o-y increase but with a rally of 58% q-o-q to 163t as a result of pent-up demand and pullback in local gold prices in Q2.

- Global gold jewellery consumption benefited from gold price pullbacks during the third quarter of 2022.
- Total consumption in gold jewellery grew up to 523.1 tonnes, which is a 10% y-o-y improvement, exceeding its five-year quarterly average (501.0 tonnes).
- Turkey recorded the strongest third quarter in 2022, with a 19% y-o-y growth, followed by India (17%).
- Demand in China has also seen a relatively modest growth of 5% y-o-y since its recovery from covid restrictions.

Figure 2.6 Jewellery demand levels (y-o-y% change)

	Q3'19	Q3'20	Q3'21	Q3'22	y-o-y % change
India	101.6	60.8	125.1	146.2	17
China, P.R.: Mainland	158.1	118.5	156.0	163.4	5
Turkey	8.3	6.5	9.3	11.1	19
United States	29.3	28.2	31.7	29.8	-6
Italy	2.8	2.4	2.7	2.8	2
United Kingdom	4.4	3.2	4.3	4.4	2
World total	469.4	332.8	476.5	523.1	10

Source: Metals Focus, Refinitiv GFMS, ICE Benchmark Administration, World Gold Council

Chinese Gold Jewellery demand: Outlook for 2023

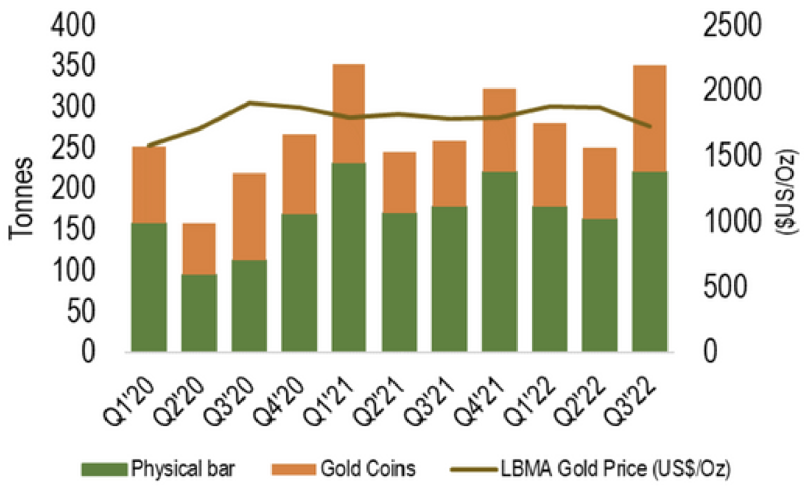
During the first three quarters in 2022, China experienced a whirlwind in demand since its full-scale lockdowns in Q2 and sizable q-o-q recovery in local economic growth in Q3 and is expecting to rebound significantly once China exits its zero-covid policy. Demand for gold jewellery especially in key cities is expected to rebound, reflecting a strong start for 2023.

Following up with the Chinese New Year holiday, sales are expected to surge up in the first quarter of 2023. Overlooking seasonal strength, other factors such as China's policy to boost consumption in local gold jewellery purchases, the society's tendency to save up on gold and the continuous return of the 'per-gram' based pricing model to promote heavier gold products contribute significantly in the recovery and stability of gold demand.

Demand: Gold Bar and Coin demand peaks — Gold's growing reputation as safe-haven assets

Following rising interest and inflation rates, retail investment demand for gold bars and coins rose to a six-quarter high of 351t, up 36% y-o-y and 41% higher q-o-q. Other factors include commercial banks' efforts in stimulating consumption as seen in China as it attempts to recover its economy and meet its current demand and seasonality opportunities.

Figure 2.7 Bar and Coin demand level increasing towards year end 2022



Sources: ICE Benchmark Administration, Metals Focus, Refinitiv GFMS, World Gold Council

Festive seasons in India play a role in rising coin demand

In Q3, Indian bar and coin demand saw a 6% y-o-y improvement as a response to lower local gold prices and weaker equity markets. The net demand of 45.3t during the quarter was 14% above the country's five-year quarterly average and is expected to pick up during festivals such as the arrival of Diwali and wedding seasons, which extends from mid-November 2022 to February in 2023.

On balance, gold's performance for the first quarter of 2023 expects to see a stable movement as a result of the competing crosswinds between its main macroeconomic drivers. Upon acknowledging the presence of uncertainty looming over the global economy, forecasts for the later quarters of the year are subjected to multiple possibilities.

Scenario 1 : Further tightening ahead

In this scenario, interest rates remain high to offset inflation, which is backed by geopolitic tensions and financial risks intervening with the market. Despite the current slowdown of rate hikes shown by the Fed, this could be a response to the risk of overtightening the policy. This will result in stagflationary conditions that can extend to a recession, adversely affecting business confidence and profitability. As major companies such as Microsoft and Amazon are also laying off employees at the start of the year, the level of uncertainty may drag along a greater safe haven demand for gold and the dollar.

Figure 3.1 Gold performs best in times of stagflation

Annualized average adjusted return (AAAR) as of Q2 2021

Asset	Goldilocks	Reflation	Stagflation	Deflation
Gold ($US/oz)	-3.1	8.4	32.2	12.8
S&P 500 Index	16.8	28.5	-6.6	11.4
EAFE equities	10.5	18.8	-11.6	11.7
US Treasury & Agency bonds	7	2.3	9.6	11.2
US Corporate bonds	10.9	8.6	6.1	14.1
S&P GSCI Index	9	34.7	17.5	-13.5
US Dollar Index	4.6	0.6	0.9	-0.7

Source: World Gold Council

Scenario 2 : Soft Landing

This scenario suggests that business confidence has been restored and customer spending has rebounded back to pre-pandemic levels. Risky assets are providing better yields and the bond markets are seeing a growth in demand, making it a competitive environment for gold. In the early quarter of 2023, the bond market had started rallying, which foreshadows the possibility that the market is facing an upside of economic recovery in accordance with the slowdown in rate hikes.

PCE Forecast

Personal consumption expenditures (PCE) inflation in December was around 2.3 percent on a 3 to 6 month basis, compared to 5.1 percent on a 12-month basis. This decline reflects on the effects of the war and decrease in core goods inflation. The figure subtracted almost three-fourths of a percentage point from the 3-month annualised total PCE inflation. The decrease in energy and core goods prices are a reversal of the previous large increases and are expected to stay moderate in the future, which may signal a reduction in core import prices and an easing in supply chains. With PCE forecasted to decrease in the near future, we are expecting a decrease in inflation as well.

GOLD : PRICE AND TECHNICAL ANALYSIS

Figure 4.1 XAU/USD Daily Time Frame (as of 20 January 2023)

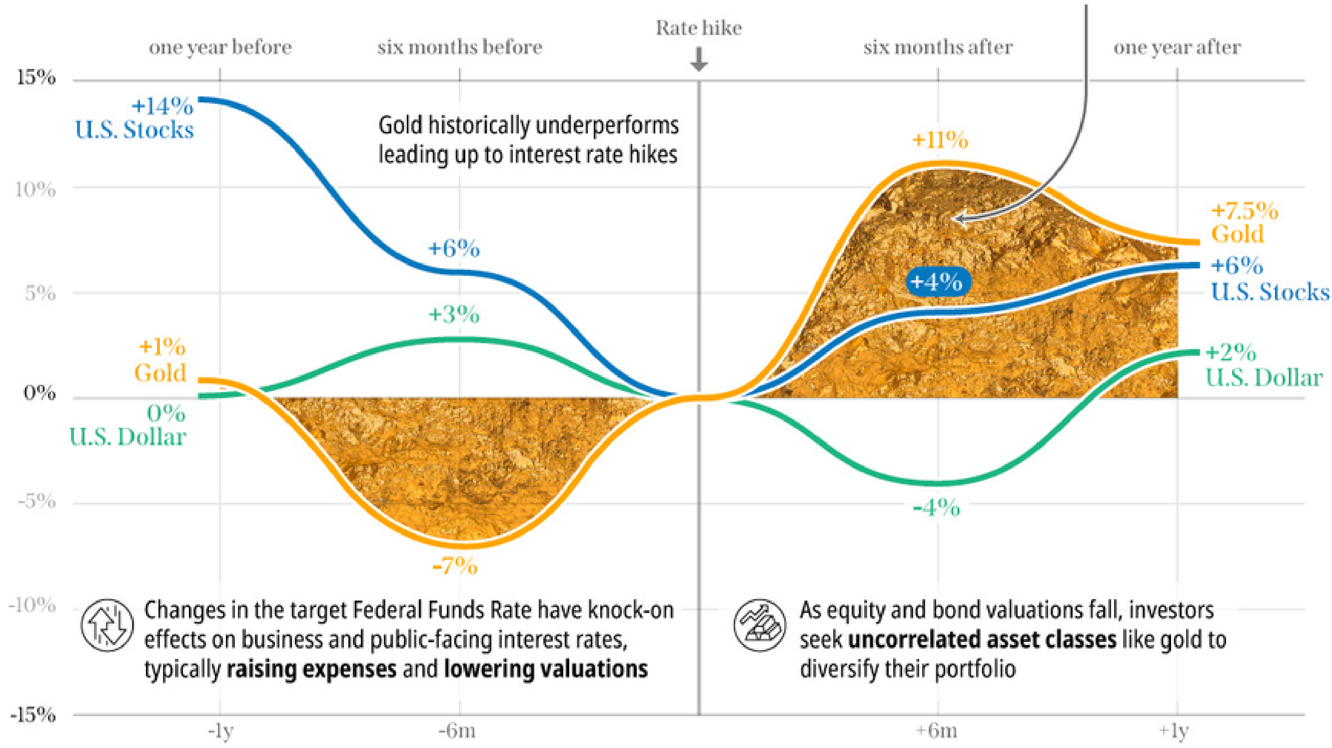
Source: TradingView

From the daily time frame, we can see that XAU/USD now is at a key level and if price breaks above this key level at US$1,920, we can see a potential long to the next daily resistance at US$2,068. However, we can also expect a pullback to around US$1,806 to $1,812 before this break. A convincing break below the US$1,806 to $1,812 might shift the near-term bias in favour of bearish traders and prompt aggressive selling around the XAU/USD pair.

GOLD : CURRENT TRADER SENTIMENT

Sentiment for gold investment at the moment is currently in the midst of uncertainty that has circulated around high inflation rates, supply chain disruptions, recent geopolitical events relating to Russia's invasion over Ukraine and China's re-opening and now the expectations of a disinflation ahead as the Fed starts to slow rate hikes and tries to pull it back to its 2%-3% target range by the end of 2023. Since gold has hit its highest at US$2,039 in early March, it has stabilized around the US$1,700 mark throughout 2022. Despite macroeconomic pressures, global mined supply of gold and physical demand remain robust and will expect a steady growth through year-end. Once interest rates begin to cool inflationary pressures and global supply chains recover back to normal, we expect gold prices to respond inversely and break below the support level of US$1,700.

Figure 4.2 Median returns in last 4 Fed cycles (1994-2015)



Source: World Gold Council, Bloomberg, ICE Benchmark Administration

The chart illustrates the movement of gold prices over time in response to flunctuations in the Fed's interest rates, comparing along with the US dollar and stocks. These are portrayed in the past Fed cycles since 1994, which holds relevant conclusions to the position of gold now and in the future.

CONCLUSION

In conclusion, it can be inferred that the price of gold is likely to experience an upward trend in the near future. As interest rates continue to decrease, the opportunity cost of holding gold decreases and it becomes more attractive to investors. The current trend in interest rates is downward, with the US Federal Reserve and other central banks around the world continuing to maintain low interest rates to support economic recovery. From the CPI and the PCE charts, we deduce that inflation may have also passed its peak and it is expected to cool down. This suggests that the price of gold may continue to rise.

Figure 5.1 Past data on relationship between gold prices and interest rates

Source: World Gold Council, Bloomberg, ICE Benchmark Administration

This is supported by historical data, for example, in the period of 2008 to 2012, where the Fed lowered interest rates, gold price increased from US$800/ounce to US$1,800/ounce.

Furthermore, gold's status as a safe-haven asset and the ongoing economic uncertainty caused by the COVID-19 pandemic are likely to sustain demand for gold. In terms of demand, we expect central banks' demand for gold to remain high in response to geopolitical tensions and for investors to hedge against the current supply chain conditions. In addition to that, the worldwide jewelry market size sees a future steady growth and is predicted to reach US$518.9bn by 2030, according to a new analysis by Grand View Research Inc. This sector is expected to expand the most, followed by gold bars and coins.

On the production side, after rebounding from COVID-induced delays, mining companies with healthy balance sheets should be able to continue investing in exploration with the advantage of favourable gold market prices on their side. Other factors such as currency fluctuations and slow economic growth are also indicators in determining the direction and volatility of gold prices.