PRECIOUS METALS UPDATE

Gold to find its feet later in the year

• In the last few weeks, we have revised down our forecast for global economic growth this year owing to the hit to activity from the coronavirus. At the same time, we now expect looser global monetary conditions. As a result, we have revised up our year-end forecast for the price of gold. However, we suspect that it will only start to benefit once the current turbulence in financial markets abates.

• At the start of the year, we thought the price of gold would fall in 2020 as global economic activity gradually picked up, the US dollar strengthened and the US Treasury yield rose a little.

• That was then. More recently, the spread of coronavirus across the globe has led to dramatic downward revisions to our economic growth forecasts for 2020, policy loosening and a slump in equity markets. In this environment, the price of gold should be benefitting from a combination of safe-haven buying (owing to the deteriorating economic outlook and uncertainty) and a significantly lower opportunity cost involved in holding a non-interest-bearing asset like gold. (See Chart 1.) In fact, the price of gold fell 6% this week.

• It seems that investors have been selling gold in order to cover losses elsewhere. There is a precedent for this. The price of gold initially fell sharply during the Global Financial Crisis (see Chart 2) despite the fact that, arguably, it should have benefitted from a flight to relative safety as all other financial assets were in freefall. Instead, and perhaps somewhat ironically, ample liquidity in the gold market means that the sale of gold holdings is a relatively quick and seamless way to raise cash in times of need.

• Looking ahead, we think that equity markets could continue to fall in the coming weeks, at least until there are signs that the spread of the virus is slowing. This is particularly the case as valuations remain relatively high. Accordingly, gold may fall further in the near term.

• Looking further ahead, we are assuming that economic activity starts to recover later in the year as the worst of the virus passes and policy stimulus starts to give a lift to demand. (That said, risks are clearly to the downside given uncertainty about the scale and duration of the pandemic.)

• What’s more, we expect the Fed to cut interest rates to near-zero before long and to confirm a resumption of quantitative easing. (See our US Economics Update.) As a result, we have revised down our end-2020 forecast for the US 10-Year Treasury yield from 2% to 0.5%, and do not expect the stimulus to be unwound as soon as the virus is under control.

• To sum up, once the worst of the financial market turmoil is over, we suspect that gold will benefit from ultra-low interest rates. But signs of some revival in the global economy will keep a lid on prices. Our end-2020 forecast for the price of gold is $1,600 per ounce ($1,400 previously), up from $1,570 today.
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