Market Insight

Gold Outlook to Q1 2024: Safe-haven demand and monetary pivots to drive gold to new highs

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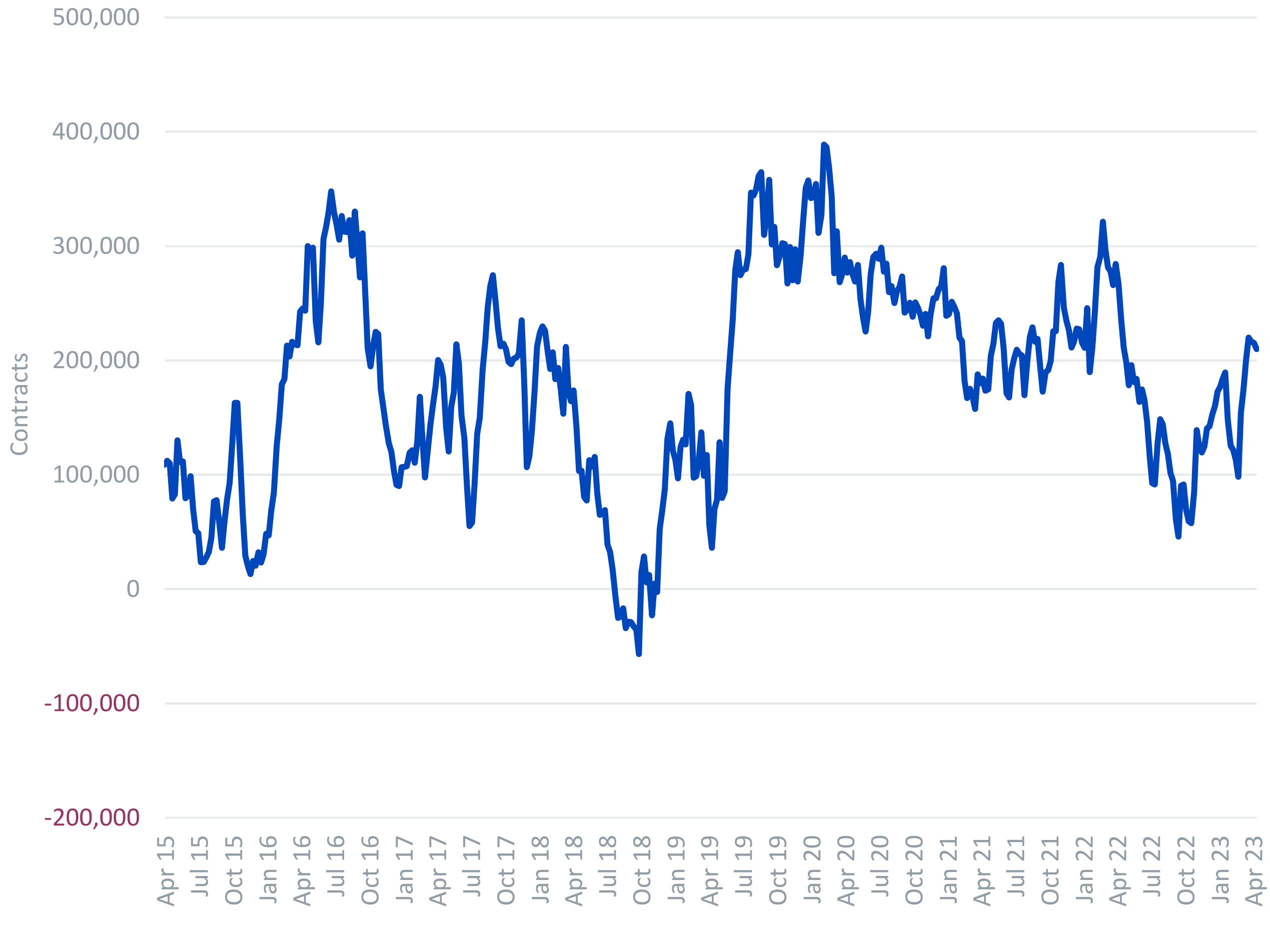
Gold entered Q2 2023 with great strength. Pulled up by banking sector woes and worries about the consequences of the US having breached its debt ceiling, gold has been flirting with near-all-time highs. Indeed, we expect gold to reach a new all-time (nominal) high by the end of the year.

Investors hedging with gold

Net speculative positioning in gold futures has risen sharply in 2023, especially after the collapse of Silicon Valley Bank. Prior to the banking concerns, positioning in gold futures - a measure of investor sentiment towards gold - was looking quite weak.

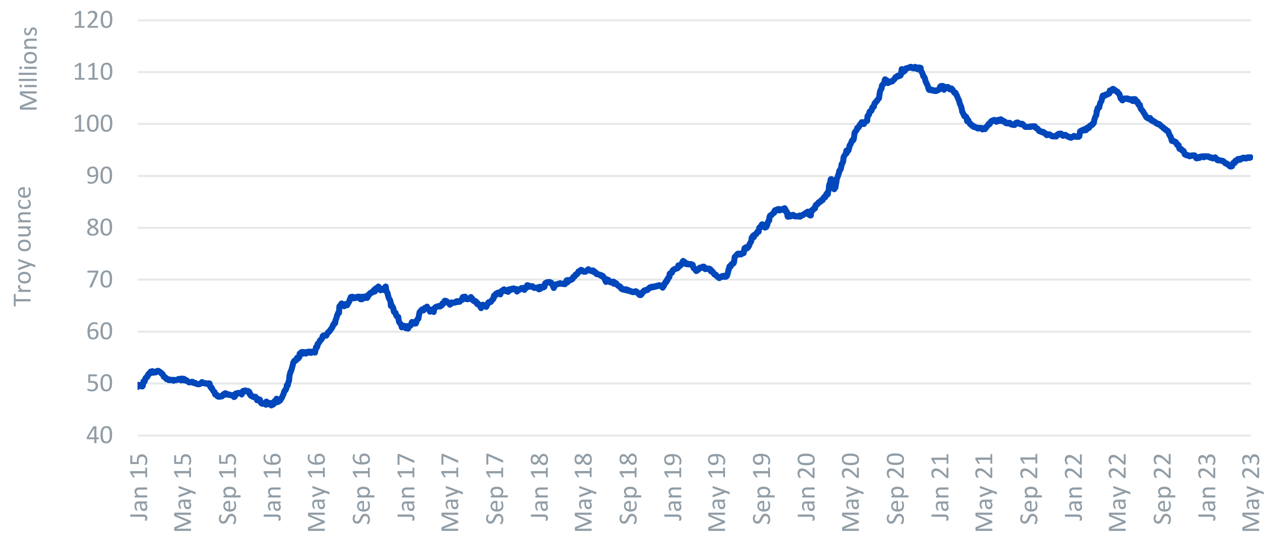
Net speculative positioning in gold futures



Source: WisdomTree, Bloomberg. April 2015 – April 2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

Somewhat belatedly, flows into gold exchange-traded products (ETPs) have risen, but not to the same extent we have observed in the futures market. Should ETP investors return in significant force, we could see gold prices rise further.

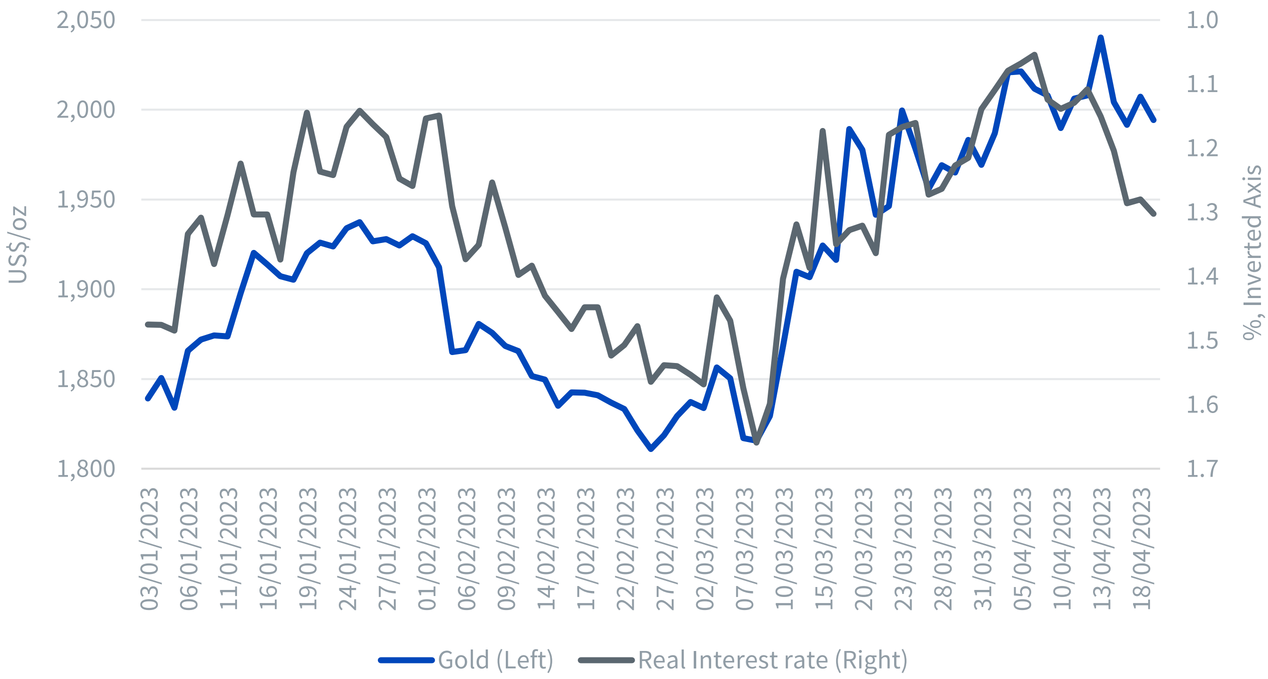
Gold held in exchange-traded products



Source: WisdomTree, Bloomberg. January 2015 – May 2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

Gold is outpacing the bond market. While real bond yields have been rising through most of April (which would normally be gold price negative), gold prices have risen.

Gold vs real rates (Treasury Inflation-Protected Securities yield)



Source: WisdomTree, Bloomberg. January 2023 – April 2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

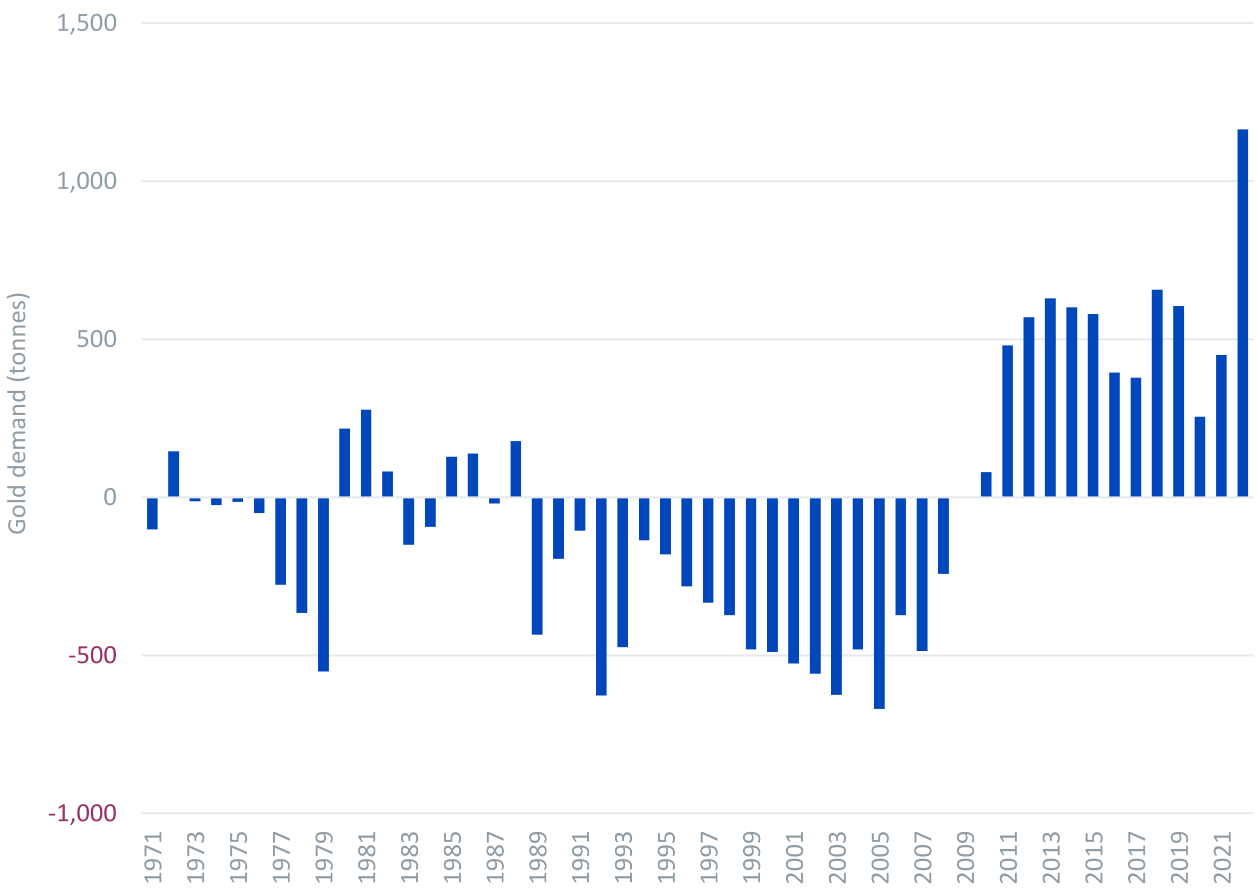
Gold as a foreign exchange diversifier for central banks

In 2022, central banks purchased record volumes of gold. That was clearly before the onset of the banking sector woes and, therefore, unlikely to be connected. Mainly developing country central banks have been the major gold purchasers in the past decade. They generally have a desire to diversify away from US dollar. The motivation is to avoid 'importing' US monetary policy. Moving to any other fiat currency (such as Euro or Yen), entails the same problems as holding the US dollar, but with potentially less liquidity. Gold, as a pseudo-currency, that has had a role, formally and informally, as the monetary instrument for several millennia, has come back in vogue with many central banks.

One of the reasons for such strong central bank gold buying last year was because the sanctions placed on Russia has spooked central banks across the world. Russia's invasion of Ukraine in February 2022 triggered a wave of US-led financial sanctions against Moscow. The two most powerful among them have been the decision by Western governments to freeze nearly half ($300bn) of Russia's foreign currency reserves and the removal of major Russian banks from SWIFT, an interbank messaging service that facilitates international payments. Moving to gold (the pseudo-currency that no central bank controls) has been seen as the most appropriate alternative.

Russia has recently submitted previously unreported information dating back to February 2022, with purchases amounting to 28 tonnes in the year.

Central bank gold demand



Source: WisdomTree, World Gold Council, Metal Focus, GFMS. 1971 – 2022. **Historical performance is not an indication of future performance and any investments may go down in value.**

Central bank buying of gold continues unabated in 2023. Global gold reserves rose by 114 tonnes in Q1 2023. That marks the strongest start to the year in terms of central bank buying gold since 2010. Maintaining such momentum after 2022 is an accomplishment. China has reported gold purchases for five consecutive months now.

Gold reaching corners previously untouched

Surprisingly, the Monetary Authority of Singapore added almost 69 tonnes of gold to its reserves in Q1 2023, marking its first purchases since 2021 and raising its gold holdings by 45% relative to end 2022. On a net basis, Singapore has been the largest gold purchaser this year so far. So, the story isn't limited to developing nation central banks. While Singapore has not offered any commentary around its purchases, it could be driven by elevated concerns on global financial conditions. Singapore being a small, externally focused nation could be more exposed than other nations to global dislocations and, hence, acting with such precautions.

The next concern: US debt ceiling

While banking sector concerns have driven this first leg of interest in gold amongst investors and FX diversification for gold amongst central bankers, the next catalyst for gold interest could lie with the US debt ceiling. The debt ceiling is the self-imposed limit on the amount of money the US government can borrow to pay for services, such as social security, Medicare and the military.

Congress is in charge of setting the debt limit, which currently stands at $31.4tn. The debt ceiling has been raised 78 times since 1960, under both Democrat and Republican presidents. At times, the ceiling was briefly suspended and then reinstated at a higher limit, essentially a retroactive raising of the debt ceiling.

Over three months ago the treasury warned that the US government had hit its borrowing limit, also known as the debt ceiling. Since then, the US treasury has been taking "extraordinary measures" to ensure the government can continue to pay its bills.

On 1 May 2023, Janet Yellen, the US Treasury Secretary, warned that the government was set to exhaust its cash reserves and run out of budgetary tricks ("extraordinary measures") as soon as 1 June 2023. At this point, the US could either face a sovereign default or severe cuts to spending. Neither outcome would be desirable, and would throw all hopes of a soft landing away. So, it will be up to Congress to act quickly to avoid an economic disaster. Even an 11th hour deal may see a lot of damage as nervous investors may pull back on risk in the fear of an accident.

We expect demand for gold as a hedge to continue to increase as result.

Gold outlook using WisdomTree's forecasts model

Using WisdomTree's quantitative model[1] , we present several scenarios for gold.

Consensus

Our consensus scenario takes Bloomberg Survey of Professional Economists average views on inflation, US dollar and Treasury yield forecasts. Consensus is looking for inflation to continue to decline (although above central bank targets), the US dollar to depreciate, and bond yields to continue to fall.

1. See our model described in Gold: how we value the precious metal

Without a consensus forecast on gold sentiment, we reduce speculative positioning to a conservative 124k, which is close the long-term average, from the elevated level of over 200k at the end of April 2023. The risk is clearly to the upside this year if a recession or financial dislocation materialises. Gold is a highly sought after asset in times of economic and financial stress, and so a recession could drive sentiment for the metal even higher.

In the consensus case scenario, gold reaches US$2,285/oz by Q1 2024, piercing through previous all-time nominal highs (US$2,061/oz on 7 August 2020) by Q4 2023 at $2260/oz. However, in real terms, this does not reach an all-time high, which was reached in January 1980. In fact, it would be 33% below that level. And, in real terms, it is still 10% below the 2020 high.

Bull case

In this scenario, the Federal Reserve (Fed) pays heed to the warning signs from the financial markets and pivots its monetary policy faster. If the US central bank begins monetary expansion by summer 2023, bond yields will be falling and, assuming it moves before the European Central bank and other major central banks, we could see the US dollar depreciate at a faster rate. We assume inflation will remain elevated as the softening stance of the Fed will fail to generate the goods price deflation that is required to bring overall inflation lower in the consensus scenario. Assuming that the financial fears that the Fed is responding to are real, we expect positioning in gold futures to remain elevated.

In this scenario, gold could reach US$2517/oz. That would be 22% higher than the all-time nominal high (reached in August 2020) and 1% higher than that level in nominal terms. However, it would be 28% below the all-time real high reached in 1980.

Bear case

In the bear case, CPI inflation falls to 1.8%, that is, below the Fed target. In essence, the Fed makes a policy error in overdoing the tightening. Bond yields rise and the US dollar appreciates as an overzealous Fed outpaces other central banks. Although we acknowledge that such a scenario increases recession risk, and therefore could be gold positive drawing more investors to the yellow metal as a hedge, for the sake of building scenarios, we cut the speculative positioning in gold futures down to 50k.

In this scenario, gold could reach US$1725/oz, retracing prices back to November 2022 levels.

Gold price forecasts

Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close April 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

	Consensus			
	Q2 2023	Q3 2023	Q4 2023	Q1 2024
Inflation forecast	4.3%	3.6%	3.2%	2.9%
Nominal 10-year yields forecast	3.62%	3.55%	3.44%	3.38%
US$ exchange rate forecast (DXY)	101.4	100	98.6	98.1
Speculative positioning forecast	180k	180k	150k	125k
Gold price forecast	US$2042/oz	US$2008/oz	US$2260/oz	US$2285/oz

Source: WisdomTree. Bloomberg Survey of Professional Economists, April 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

	Bull			
	Q2 2023	Q3 2023	Q4 2023	Q1 2024
Inflation forecast	5.0%	4.5%	4.0%	3.5%
Nominal 10-year yields forecast	3.50%	3.30%	3.20%	3.00%
US$ exchange rate forecast (DXY)	100	98	96	94
Speculative positioning forecast	200k	200k	200k	200k
Gold price forecast	US$2130/oz	US$2120/oz	US$2420/oz	US$2517/oz

Source: WisdomTree, May 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

	Bear			
	Q2 2023	Q3 2023	Q4 2023	Q1 2024
Inflation forecast	3.0%	2.8%	2.4%	1.8%
Nominal 10-year yields forecast	4.10%	4.25%	4.20%	4.10%
US$ exchange rate forecast (DXY)	104	106	108	110
Speculative positioning forecast	90k	80k	75k	50k
Gold price forecast	US$1775/oz	US$1735/oz	US$1730/oz	US$1725/oz

Source: WisdomTree, May 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

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