WEEKLY ANALYSIS

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GOLD IS LOOKING PROMISING AGAIN

Rising production costs. Decline in mining production and recycling supply. Falling interest rates and dollar boost gold prices. Renewed demand for bullion and coins. Return of ETF fund flows.

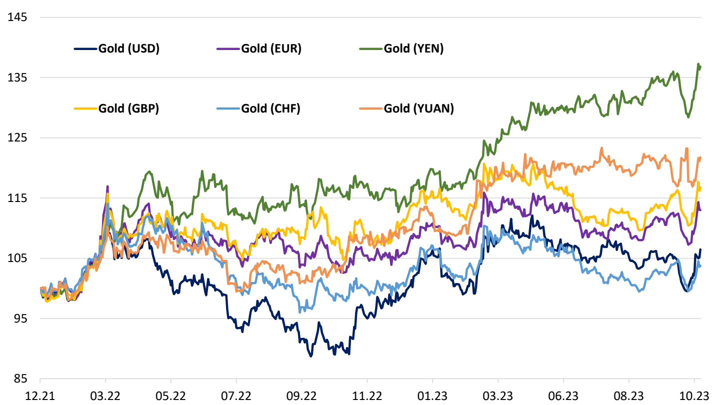
Key points

- Gold's uptrend set to resume soon
- Towards a probable imbalance in the gold market
- Sharp rise in production costs
- Mine production expected to decline
- Decline in recycling supply
- Revival of jewelry demand
- Bullion investment driving demand
- Fall and recovery in central bank purchases
- Gold to benefit from falling interest rates and dollar
- Lower cost of carry

Gold's uptrend set to resume soon

After rising by almost +13% in the first four months of the year, gold prices then slowly eroded as the US Federal Reserve tightened monetary conditions and bond yields rose, not only in dollars, but in other major currencies too. After an initial drop in the 2nd quarter (-7%), which wiped out almost half of the rise at the start of the year (+13%), the fall of the last few days of September, directly correlated with the latest tensions on long rates towards 4.8%/year, finally reset the performance counters to zero for the yellow metal in 2023. The price of an ounce of gold in dollars (1'860 USD/ounce) is now well below its 200-day average value (1'928 USD/ounce), following divestments in favour of investments offering a higher yield of around 5.5% in USD in the short term. Physical gold ETFs have thus seen outflows of almost -20% since their peak in 2020, and -7% in 2023 alone. While in 2023 the dollar trade weighted price has only appreciated by +2.4%, the increase since the July low is still +7%. The recent context for two important factors monitored by investors to assess opportunities for gold price recovery have been negative, but in our view they are in a likely transition phase. From this perspective, they could now support a new trend in the price of the yellow metal, which could prove to be more positive in the long term. Indeed, the tensions observed on the yield curves today seem to us to be disconnected from economic reality and will not withstand statistics showing a deterioration in the economy. Further downward adjustments in interest rates will also penalize the dollar, and should contribute to an upward revival in gold prices above $2,000 an ounce.

Gold Prices in Various Currencies



Sources: Bloomberg, BBGI Group SA

Towards a probable imbalance in the gold market

However, the main fundamentals of the gold market remained relatively stable, according to the latest statistics published by the World Gold Council and others. Global gold supply rose by around +7% year-on-year to 1,255 tonnes in the last quarter under review, driven by all segments. Mining production was up, as was recycling, and so was producer hedging. On an annual basis, gold supply would therefore have reached almost 4,020 tonnes. Quarter-on-quarter, the increase was from 1,204t to 1,255t, largely due to higher mining production, which rose from 857t to 923t. On the demand side, the increase was similar to the year-on-year comparison, as overall demand also rose by +7% to 1,255t, or 4,020t per annum.

This increase was mainly driven in the 1st half by investment demand, up +20% to 256t. Quarter-on-quarter, however, demand declined from 275t in the previous quarter. Jewelry demand remained particularly stable (0%) year-on-year, but slipped sharply quarter-on-quarter from 511t to 491t. Demand from central banks fell sharply by -35% year-on-year, and even more significantly over the quarter, from 284t to 102t at the end of June. Finally, demand for ingots and coins rose by +6% year-on-year, despite a three-month decline from 304t to 277t. Against this backdrop, gold prices followed virtually the same trend, rising by +6% year-on-year to $1,975 per ounce at the end of June. In our view, the situation over the next few quarters will be significantly different, affected in particular by an increase in demand for investment, ingots and coins, but also by a significant reduction in supply, due in particular to a drop in recycling. We believe that the gold market will see an increase in demand at a time when supply will be in a phase of reduction, pushing the price of the yellow metal above $2,000 an ounce.

Mining production up +4% year-on-year

The first available mining data suggest that mine production (923t) increased by +4% year-on-year. This is the highest production for a 2nd quarter since 2000, narrowly beating the previous record of 899t set in 2018. Combined with Q1 production (857t) - also a record for this time of year - this generated record mine production of 1,781t for H1 2023, +2% above the previous record set in 2018. Quarter-on-quarter, production was up +8%, mainly due to the normal seasonal fluctuations that limit production in the first quarter, when open-pit and alluvial mining operations are curtailed or halted in some very cold climates, particularly in Russia and other CIS countries. Similarly, South Africa's gold mining industry is subject to reduced production over the long summer vacations of Christmas and New Year. Four countries are responsible for the increase in world production: South Africa (+29%), Ghana (+20%), the USA (+11%) and finally Russia (+7%). For the first time in two years, Chinese production remained undisturbed, following a resumption of production after earlier shutdowns for safety reasons. In some countries, operations were affected by lower grades (Argentina -10%), production suspensions (Australia -2%) or conflicts (Sudan -10%).

First-half trends suggest that mine production will reach a new all-time high in 2023, surpassing the previous record of 3,656 tonnes set in 2018. The increase in mine production is by no means certain, however, particularly in view of the sharp rise in operating costs and the fall in gold selling prices in recent months. We remain more cautious on the evolution of the real capacity to increase production in this context and rather expect a decrease in H2.

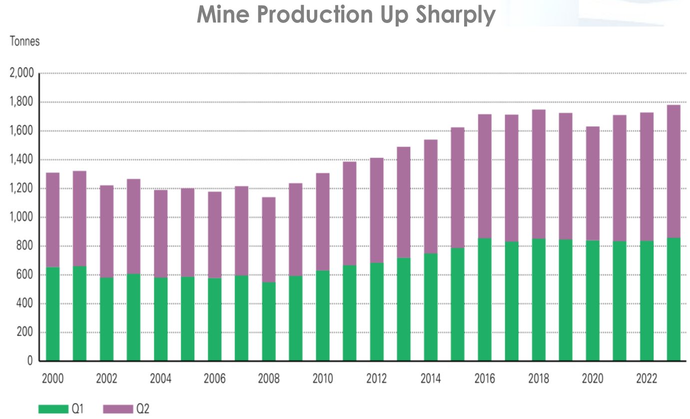
Gold recycling increased by +3%.

Over the same period, gold recycling rose to 322t (+3% over the quarter and +13% year-on-year), the highest level since the 4th quarter 2020. Excluding robust gains in India and China, the rest of the world saw a slight decline in recycling volumes - despite a record average gold price of $1,976 per ounce for the quarter. Recycled gold volumes rose by +9% year-on-year to 634t over six months, representing the highest half-year since 2016. China and India drove the supply of recycled gold. Three factors drove this increase: firstly, last year's COVID disruptions had reduced recycling supply; secondly, much weaker-than-expected jewelry demand triggered recycling of wholesale stocks after disappointing trade fairs in April; and thirdly, supply reacted to high local currency prices. The supply of recycled gold in the USA and Europe increased only marginally, despite higher gold prices. Low unemployment and a resilient economy seem to have cancelled out the effects of the cost-of-living crisis on gold recycling, and some reports are already pointing to the depletion of gold stocks for recycling. Recycling supply is thus likely to weaken with the fall in gold prices of recent months, before recovering moderately. This component of overall supply will reduce its contribution towards the end of the year.

Producer hedging slows down

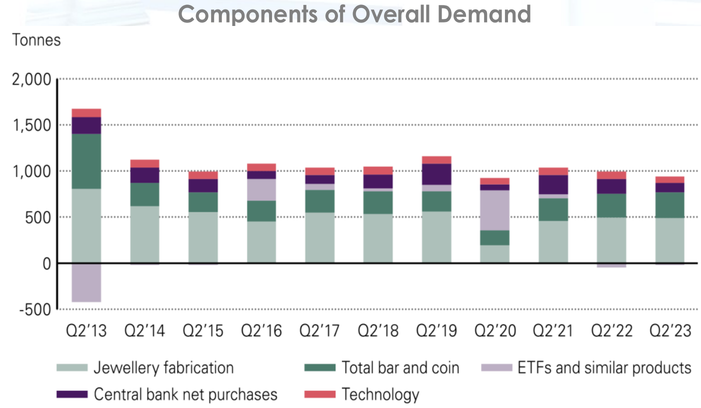
Initial estimates published by the World Gold Council suggest that growth in net hedging has continued, but at a much slower pace. The decline from 36t to just 9t is probably not yet definitive, but essentially suggests that producers significantly hedged their production when prices approached and exceeded $2,000 per ounce at the end of Q1, and then reduced their sales when prices slipped, de facto reducing the attractiveness of these hedging strategies.

Mine Production Up Sharply



*Data as of 30 June 2023. Quarterly data available from Q1 2000.
Sources: Metals Focus, Refinitiv GFMS, World Gold Council

Components of Overall Demand



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Source: Metals Focus, Refinitiv GFMS, World Gold Council

Prices had approached and exceeded $2,000 per ounce by the end of Q1, and then reduced sales as prices slipped, de facto reducing the appeal of these hedging strategies. In the previous quarter, net hedges were revised upwards on the basis of company results, and this may well be the case again in the coming months. The delta-adjusted producers' hedging book was adjusted to 36 tonnes, after an initially lower estimate. New hedging activity was clearly driven by producers operating in South Africa and Australia, who took advantage of high local currency gold prices and steeper forward curves, while in North America, forward sales seemed to correspond to project or debt hedging. The fall in gold prices that lasted below the $2,000 mark between May and September is unlikely to have motivated many producers to hedge their positions. Despite the expected recovery in prices towards the end of the year, we expect hedging positions to have a negative impact on the overall level of physical gold supply.

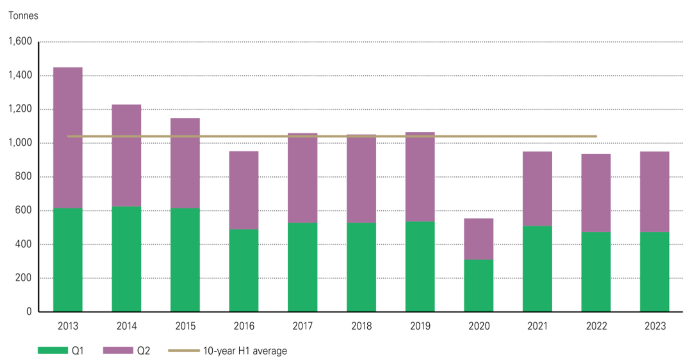
Sharp rise in production costs

The inflation figures published for August in the United States confirm the new regime that has been in place for the past twelve months. Since then, it has been fluctuating between +0.6% and 0% per month, well below the +1.2% recorded in June 2022. It had averaged just +0.25% for several months prior to the August rebound driven by energy prices. Inflation is receding significantly and returning to an increasingly satisfactory monthly pace. The price index excluding food and energy joined this trend with a reduced increase of +0.3% over the month in August. Among the elements that are still holding up, we find almost exclusively the « rents » component, which is holding back the general downtrend somewhat, although we note that services have been making a reduced contribution for some months now. We therefore believe that the expected gradual reduction in inflation to an acceptable level is still a valid trend. Furthermore, producer price indexes (excluding food and energy) have been stabilizing for the past year, averaging +0.2%/month. Inflation therefore seems to be following the expected trend and continuing to decline, without the need for massive new restrictive measures by the Fed. In our view, the causal relationship between unemployment levels, growth, policy rates and inflation is not so clear-cut, particularly when we consider that price trends were more a phenomenon of supply bottlenecks after the pandemic, rather than excess demand.

Jewelry demand up year-on-year

Global gold jewelry consumption in Q2 of 476 tonnes was +3% higher year-on-year, with China's strength outweighing India's weakness. Demand was virtually unchanged from the previous quarter, bringing six-month demand to 951t. Q2 manufacturing volumes of 491t resulted in a 15t increase in inventories. This was partly due to Chinese demand failing to meet manufacturers' expectations. Against a backdrop of very high gold prices, jewelry demand has been remarkably resilient since the beginning of the year. China's recovery from the consumption slump of 2022 partly explains this dynamism. The sector's prospects for the rest of the year are moderate, given that prices have remained well supported and consumers in much of the world are facing a deteriorating economic situation. Demand for gold jewelry in China reached 132t in Q2, up 28% year-on-year. This significant growth is, however, built on a low basis of comparison due to the stringent COVID-related closures that affected the market last year. Demand for the first half totaled 328t, up +17% year-on-year, but -4% below the ten-year average. The end of the « zero COVID » policy laid the foundations for a rebound in demand for gold jewelry in China in the first half of the year. The wedding demand accumulated over the past year also provided support. In addition, gold's unique dual nature as both a value-preserving asset and an everyday accessory, continued to attract attention in Q2, as the local economic recovery became increasingly uncertain and the yuan depreciated. That said, demand has yet to return to its average level of the last ten years. The record quarterly average of the local gold price in yuan weighed on demand. Indian consumption of gold jewelry fell by -8% year-on-year to 129t in Q2, undermined by record gold prices. This brought six-month demand to 207t, down -12% year-on-year. 18k gold jewelry continued its upward trend, as consumers were attracted by the affordability of these products. Given the price of gold, it would have been reasonable to expect a much lower demand for gold jewelry. But it's fair to say that the favorable economic context has helped, with GDP growth forecast at +6.3% for fiscal year 2023/24. A spontaneous reaction to the ban on 2,000 banknotes during the quarter had a brief but noticeable impact on gold demand. Although demand has held up relatively well since the start of the year, we also support the moderate outlook for the second half.

Jewelry Demand



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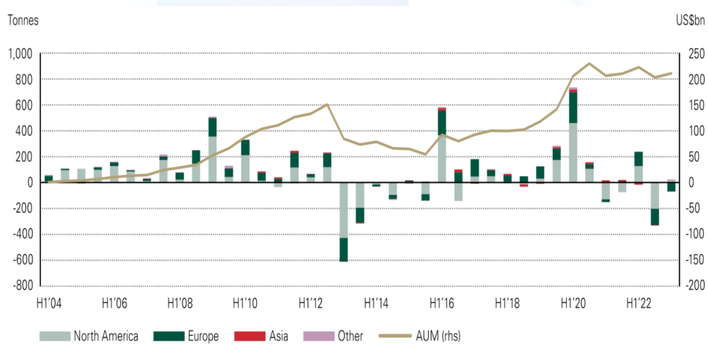
Source: Metals Focus, Refinitiv GFMS, World Gold Council

ETF Physical Gold Investment Flows



*Data as of 30 June 2023.
Source: Bloomberg, Company Filings, ICE Benchmark Administration, World Gold Council

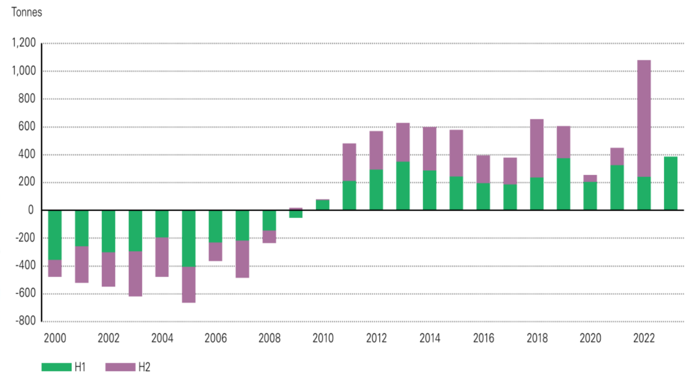
Bullion investments drive demand

Demand for bullion rose by a very substantial +20% to 256 tonnes year-on-year, while demand for ingots and coins also advanced by +6% over the same period. Turkey, China, India and the Middle East continued to play a major role in the latter, accounting for around 277 tonnes. Demand for gold coins is the main driver of growth in investment demand, while bullion purchases have declined slightly. Demand for ETFs reacted strongly negatively at the end of the quarter, after several months of growth. The fall in gold prices and the rise in financial assets against a backdrop of strong competition from much higher bond yields together reversed the short-term trend, causing demand for physical gold held in ETFs to plummet, particularly in Europe (-29t), a trend which contrasted with some resilience in the United States. The current context of very high interest rates is obviously a brake on any rapid recovery in gold prices and ETF investment demand. However, we believe that interest rates have already reached the peak of the current monetary tightening cycle, which means that key interest rates will soon ease in 2024. In the meantime, the emerging economic slowdown will most likely cause yield curves to steepen, which will then benefit gold prices. The prospect of easing interest rates is therefore a very important factor in supporting gold prices and boosting investment demand for ETFs, as well as bullion and coins.

Fall and recovery in central bank purchases

Demand from central banks contracted by -64% in Q2 and -35% year-on-year. Thanks to a very strong Q1, central bank demand was finally strong in H1 2023, with estimated purchases of 387t, the strongest half-year in historical comparison since 2000. The slowdown in Q2 was mainly due to strong sales orchestrated by Turkey's central bank after having been a positive contributor in the previous quarter. The TCMB sales appear to be tactical and temporary, and we expect purchases from Turkey to resume in the second half of the year. Gold prices therefore failed to benefit from central bank demand, which declined overall but remained positive at around 103 tonnes. It should benefit from a resumption of purchases by central banks in emerging countries in the 2nd half of the year.

Central Bank Demand



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Source: Metals Focus, Refinitiv GFMS, World Gold Council

Lower cost of carry

The cost of carry is the cost of holding physical gold over a given period. Carrying costs include insurance, storage and interest on invested funds, as well as other ancillary costs. For most investments, the cost of carry generally refers to the risk-free interest rate. Storage costs (usually expressed as a percentage of the spot price) must be added to the gold's cost of carry. The massive rise in interest rates over the past few months has obviously penalized gold prices by increasing the cost of carry of the yellow metal. The 150 bp rise in long rates, but even more markedly the rise in short rates to 5.75%, has had a considerable impact on the cost of holding gold. The end of the US Federal Reserve's restrictive monetary policy and the implications for yield curves and financing costs of a forthcoming reversal in interest rates, should be an important factor in supporting the outlook for the yellow metal in 2024.

The expected fall in interest rates against the backdrop of a probable economic slowdown will have the opposite effect to that which the tightening of monetary conditions had on gold prices from March 2023 onwards. Lower carrying costs will once again be a supportive factor for prices.

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