Is Gold losing its shine?

Gold prices collapsed 25% to multi-year lows near US$1,235/oz to finish 2Q13, which saw $13.5Bn in net outflows across precious metals ETFs. The question on everybody’s mind: “Is gold really losing its shine?” Well, Citi analysts remain bearish towards the precious metal, forecasting gold prices to average US$1,150/oz by the fourth quarter, and with an expectation that prices could push through the US$1,100/oz level before year end. Citi’s 2013 and 2014 full year average price forecasts are US$1,358/oz and US$1,145/oz respectively.

A key driver for this view is the expectation that the US Federal Reserve could move to taper its US$85 billion per month asset purchase program of mortgage backed securities before the end of the year, prompting higher bond yields and a further strengthening of the dollar. Indeed, with employment levels being one of the key metrics the Fed is following in order to determine the timescale of its current asset purchase scheme, Non-Farm Payrolls data have been in positive territory for much of this year, indicating that the US economy is moving onto a more sustainable growth footing.

April’s price destruction however had little to do pronouncements from the Fed, or even any market moving macro data, or news, but was largely prompted by a surge of fund driven sell orders hitting the Comex market on April 12th, pushing prices down through key support levels, which in turn prompted a wave of technical selling. The downward moves were exacerbated by significant outflows from physically backed exchange traded funds (ETFs), with 174 tonnes of gold redeemed from funds during April, the largest monthly outflow in the year-to-date, and indeed, of all-time.

Investors looking for greener pastures

ETFs represent the most visible investor sentiment towards the gold market, with the outflows becoming somewhat self-reinforcing, in that the outflows remove confidence in investing in an ETF in the first place, and in turn prompt further outflows. In the year-to-date, outflows have reached 595 tonnes, and Citi analysts expect volumes to continue to flow out over the remainder of the year, with total outflow forecast to reach 850 tonnes for the year as whole. The April price moves severely damaged the notion that gold provides any degree of risk protection or really acts as a safe haven, and Citi analysts see little prospect of investors returning to gold in the short or medium term. Indeed, Citi analysts expect the gradual improvements in the US economy to persist, and Europe to maintain some semblance of stability, prompting investors to continue to buy into recovery linked asset classes such as equities at the expenses of gold.
No inflation fears for now

Additionally, gold bulls have been somewhat confused as to why the significant surge in central bank balance sheets (Fed’s 250%) has not translated to higher inflation/inflation expectations, and thus been highly supportive for gold, particularly in the current low interest environment?

The simplest answer is that money printing has not translated into increased demand for money. Indeed, public sector austerity drives to rein in levels of debt have been a clear factor at play here, as has the general trend in deleveraging at both a public and private sector level, reducing demand for credit. In addition, regulations requiring banks to increase capital ratios have meant that banks have been forced to sit on increasing holdings of cash against risk. All of these issues have essentially negated the impact of printing driven increase in money supply.

In addition to a diminishing fear of the prospect of inflation, concerns over the future of the dollar and its status as the world’s reserve currency also appear to have subsided. Indeed, many of the fear/safe haven arguments for holding gold do not currently stand up to scrutiny.

Little real fundamental support

April’s price fall spurred a significant pick up in physical demand for gold notably in the Middle East and Asia (with the exception of India). However, this demand jump is unlikely to be sustained over the summer, as demand is becoming “filled” at current price levels, a further move down in prices may be required to sustain demand at April/May levels. In contrast to other Asian markets, Indian demand has struggled under restrictions on consignment trade, while the increase on import duties from 6% to 8% has negated recent Rupee/USD stabilisation.

Central bank buying of gold appears to have softened over the first half of the year, largely due to the continued fall off in gold prices. Indeed, significant buying activity has only been seen from Russia this year (34 tonnes between January and April). Given Citi’s expectation of a relative stabilisation of gold prices in 2014, they forecast central bank buying to expand from a net 400 tonnes this year to 480 tonnes next year.
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