Sucden Financial

FX Monthly Report– Gold

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FX Monthly Report

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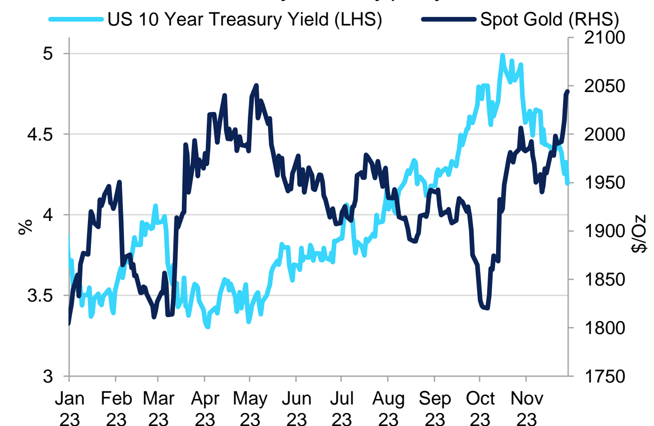
Gold Focus

Gold prices have fluctuated significantly this year as speculation surrounding monetary policy across the world affected global sentiment across major asset classes. The banking crisis in March propelled prices to rally to a high of $2,050/oz, but by the end of Q3, gold was heading for its worst monthly performance in over two years due to elevated inflation forcing central banks to raise interest rates relentlessly. Since then, the trend has reversed sharply once again, first brought on by escalating tensions in the Middle East in October, reviving its safe-haven reputation. While such safe-haven effects are often short-lived, we believe that it is the combination of the monetary policy path from major central banks, along with the weakening dollar, that is now supporting gold's performance, prompting it to breach the record high of $2,100/oz, making gold one of the best-performing commodities so far this year, gaining as much as 13% YTD. As a result, hedge funds trading COMEX futures increased their bullish bets to July highs of 0.144m.

US 10-year Treasury Yields vs Spot Gold

Gold continues to be driven by monetary policy outlook out of the US.

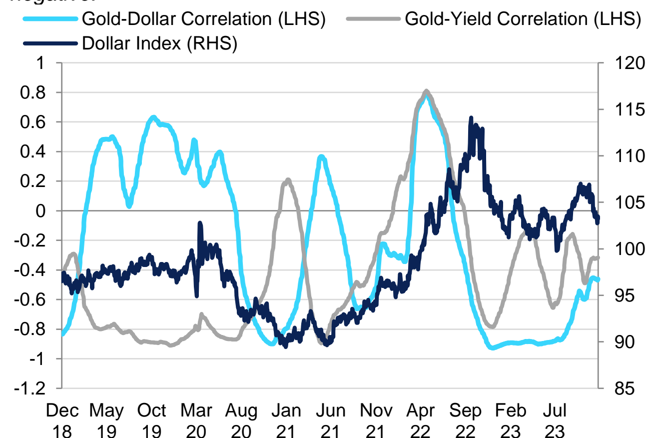


Source: Bloomberg

Despite the resilience in the US economy, ongoing price softness aligns with expectations of the end of the tightening cycle, pushing longer-term yields lower. Gold, as a non-yielding asset, was the primary beneficiary of this trend, and we expect these tailwinds to build up, supporting gold momentum into the year-end. We see that there is still little fundamental incentive to push gold above the $2,100/oz level decisively – the confirmation of an actual cut from policymakers might prompt gold higher. But in the meantime, we expect it to test the $2,100/oz resistance in the near term. Indeed, monetary policy guidance has been key in driving precious metals' longer-term trend, and we have seen gold and 10-year US yield correlation maintain at a -50% level in Q3 2023.

Dollar Index vs Gold-Yield and Gold-Dollar Correlation

Gold's correlation with the dollar and Treasury yields remains strongly negative.

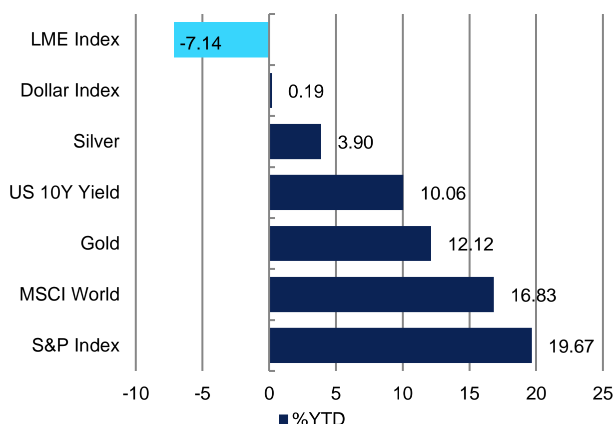


Source: Bloomberg, Sucden Financial

Elevated CPI in Q2 and Q3 2023 led to continued tightening of the monetary policy cycle to combat upwardly sticky prices, causing gold to deteriorate. However, with inflation softening at a healthy pace and major economic indicators in the US pointing to a moderating economic environment, the case for the end of the tightening cycle has gained traction. This trend accelerated in November when markets pretty much discounted the case for another hike this year. At the same time, the case for interest rate cuts in the first half of the next year has become a strong headwind for yields, and vice versa for gold, despite policymakers' persistence in the higher-for-longer narrative. The 10-year US Treasury yield has retraced 45% of this year's gains, bringing it back to 4.30%. Forward swaps now indicate expectations of cuts starting in May, supporting gold's near-term upside.

YTD Performance Across Major Assets

Gold's performance this year is on par with US equities, suggesting a fundamental shift in precious metal's narrative.



Source: Bloomberg, Sucden Financial, ICE, LME

As markets price in the end of the tightening cycle, we expect the impact of data to have little impact on sentiment into the year-end.

Moreover, we expect macroeconomic prints to remain within expectations, reaffirming the market's view of the Q2 2024 cut. As a result, we expect treasury yields to find support at current levels, including a 4.30% level for the 10-year US Treasury yield. This should create further upside for gold in December, although the scale of the upside is likely to be marginal following the recent jump on the upside. The $2,000/oz level is a robust support and breaking well above $2,100/oz will require another bullish argument, such as the confirmation of an interest rate cut. If that doesn't happen, we expect gold to struggle above this level.

From the physical side, China has once again reemerged as the largest net importer of gold, with 78t purchased in Q3 2023. China's central bank lifted temporary restrictions on gold imports in September, which helped narrow the spread between Shanghai and London from $150/oz to $42/oz, as demand for local purchases improved. As a result, China has imported about 900 tonnes of gold so far this year, the highest in five years, and with restrictions now removed, we expect this trend to accelerate into the next year. Positive futures flows have led to a slowdown in the downside for global gold ETFs for the first time since May, with the total level plateauing at around 86.23m oz.

Gold Spot vs Total Known ETF Holdings

Recent gold upside has prompted ETF's outflows to slow down.

Source: Bloomberg

In Q1 2024, we expect central banks to come forward with their commitment to maintaining higher-for-longer rates in an attempt to uphold the yields at higher levels. As the focus shifts to the impending cutting cycle, increased volatility is anticipated around the Q1 period due to the prevailing uncertainty surrounding the monetary policy outlook. Even the equity bull cycle is unlikely to derail gold's path. That being said, none of these factors should detract from gold's bullish fundamentals. Approaching the start of looser monetary policy from major central banks alongside weakening global macro will add more tailwinds to gold price performance than headwinds. We still believe that the upside for gold will be marginal, and gold is likely to follow a zig-zag pattern as it edges higher.

Desk Comments

GBP

The BOE last meeting of the year is next week, and nothing is priced in. The short, dated curve in the UK is inverting at a smaller pace than that of the US and EU due to inflation easing at a slower pace. 25bp of cuts are priced in by the end of Q2 next year.

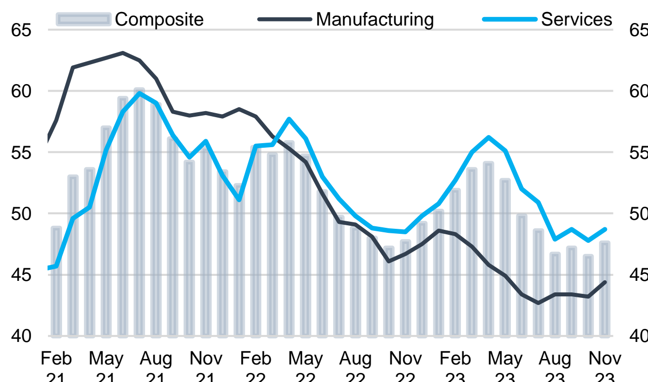
In addition, the UK's labour market remains robust, with wage growth at 8% far above the 2% inflation target. House prices are also unexpectantly rising as mortgage rates ease and homebuyers return to the market. Recent data indicates resilience in the economy and is on track to post its best monthly gain against G7 currencies. GBP flow dynamic has been two ways but any strength in the DXY is being faced with a resilient GBP. Downside 1.2550 acts as support and we expect the pair to continue trading sideways. In the medium term, GBP should benefit from the carry as we enter Q2 next year, so we favour an upside move when rate paths diverge and the UK policy remains restrictive for longer.

EUR

EUR momentum gained traction last month as the USD stalled on rate cut expectations. The EUR traded as high as 1.1017 before giving back gains in the past week. Inflation came in below expectations in the euro area. Core inflation has ticked lower, down to 3.6% from 4.2% meaning the headline number has come in below consensus for the past 3 months. Markets are now pricing an extra 25bp of cuts next year. The ECB deposit rate is now pricing 3% by July so a full 100bp of cuts priced. There is a similar rhetoric in other G7 nations, but we see EURGBP being an attractive short on the back of recent data releases. Namely PMI data. Both services and manufacturing beat to the upside in the UK with a clear gap between the eurozone making a sell on EURGBP an attractive trade in the short term. The risks in the Eurozone economy still remain to the downside, recent macro data suggest the economy is stagnating. Real GDP contracted in Q3, indicating yearly growth is close to 0 and the recent hiking cycle is still to work its way through the economy. Forecasts show the impact of each bp hike has a direct effect on an economy's growth.

Eurozone PMIs Performance

Manufacturing performance is seen improving in line with services.



Source: Markit

We are seeing a lot of two way flow in EUR so vols are likely to remain low through to year end, but we favour a downside bias. EURGBP look to sell into any rallies and looking for a downside break through 1.08 support in EURUSD.

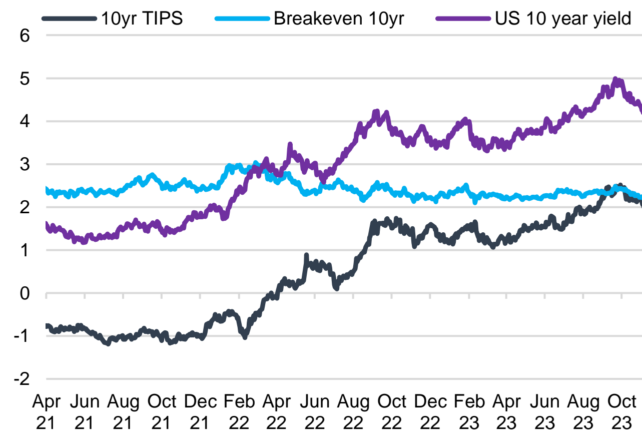
USD

USD index posted its largest monthly decline of 2023 last month leaving the index fairly unchanged on the year amid shift in expectations on Fed's rates from hikes to cuts. Dollar suffered as market participants brought forward expectations for reductions next year with the first one now expected in May 2024 compared to July 2024 at the end of OCT. With the FED adamant they will be guided by Economic data, the US data softening has been fuelling this narrative.

The upcoming US Jobs and Inflation data is likely to have heightened impact on FX markets and will likely drive momentum into the new year. We expect data to continue with the recent trend and show the US economy cooling but would like to add much of this has been priced in and this shift in the timing of rates has been slightly over reactionary in our opinion.

10yr TIPS vs 10yr Breakeven vs 10yr Yield

Breakeven yield is drifting lower as US nominal yield softens, falling below 4.50%.



Source: Federal Reserve

It is not just in the US, which is seeing repricing in rate cuts, but similar picture is materialising across the Major economies, increasing hopes of a soft landing, supporting equities which in turn has fuelled the broad sell off in the USD. We expect this theme likely to continue into January/Feb provided upcoming date shows no surprises. In addition, looking back at historical moves the USD does not fair that well in December.

We expect the rest of the Q1 and Q2 to be fairly range bound for the USD as country specific factors will pull the dollar in different directions. Currencies who have suffered due to dollars positive carry are in our opinion likely to see the largest appreciation, while EM are like to see depreciation amid cooling economies as result of the recent hiking cycle.

Looking further ahead into 2024 besides monetary policy the US general elections and the wide ranging possible economic policies are likely to be an influencing factor for the USD and the US economy.

Technical Analysis

GBPUSD

GBPUSD has bounced strongly after breaking above the blue trend line, retracing to the 61.8% fib level of the down move in Q3. We could now see a period of consolidation between the white and green trendlines with a breakout indicating next direction. On the downside, a break below green trendline could pave the way for a move down to 1.18, with support beyond there coming at 1.1420 (61.8% fib) . On the upside, a break above 200-day MA/ trendline could lead to retest of yearly highs at 1.3142, with a break above could see the cross target 2022 highs @ 1.3749.

EURUSD

EURUSD bounced back strongly retracing back up to 61.8% Fib retracement level of the move in Q3 after failing to close below 1.05. We now expect to see some consolidation between the 2 Red trendlines. On the upside, a break above Red trendline/200day Ma could see market test highs from July, with resistance beyond there coming at 1.1495/1.1500. On the downside, close below the triangle could see the retest 1.05 / 1.0448(lows from Sep), with a break below likely to lead to further declines to 1.04 and then 1.02 (61.85 Fib).

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