Perspectives on bullion

Commodities – United States | 05 May 2016

HSBC Global Research

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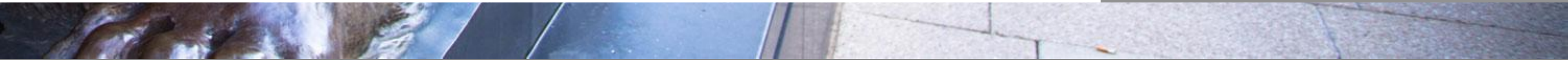
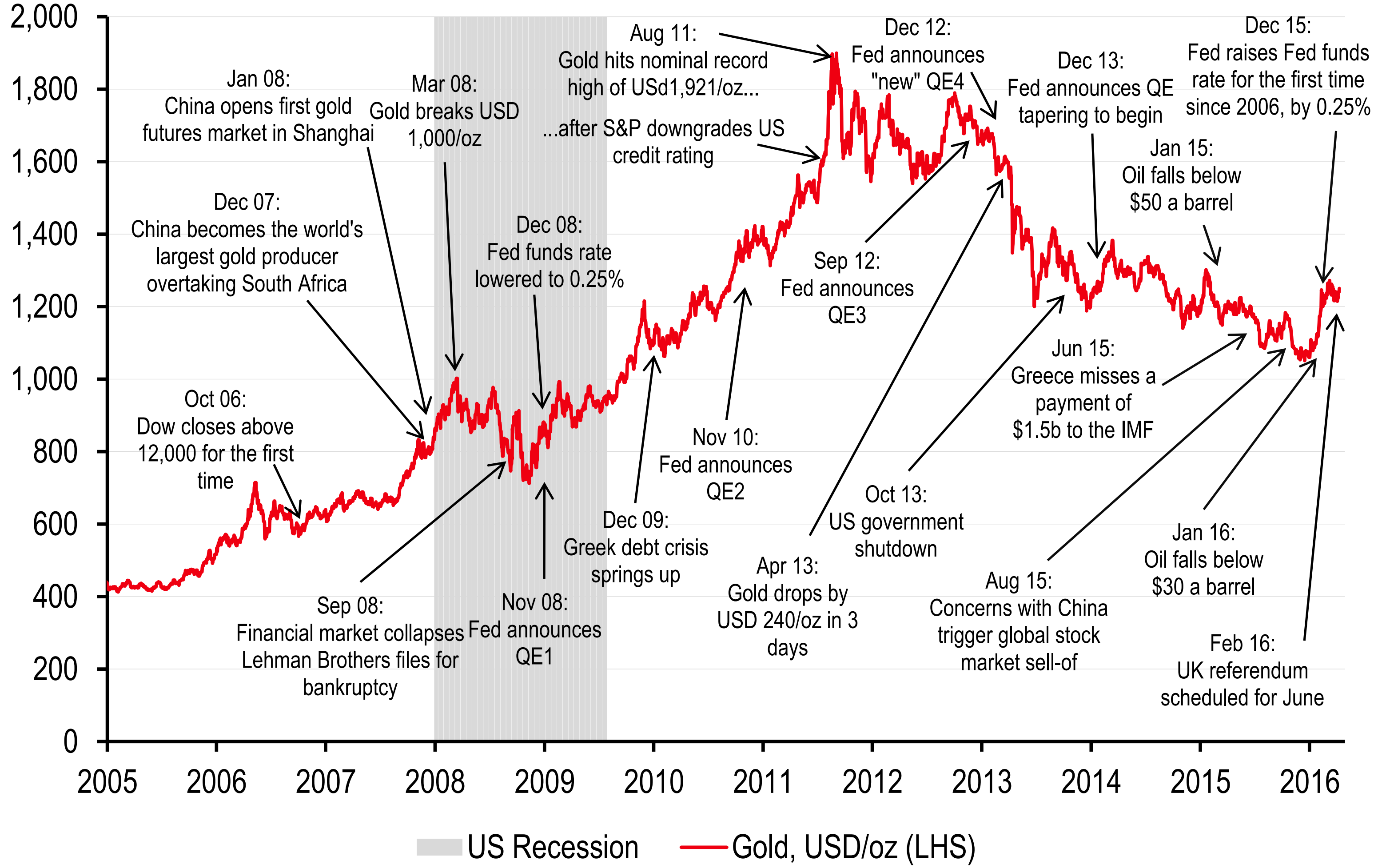
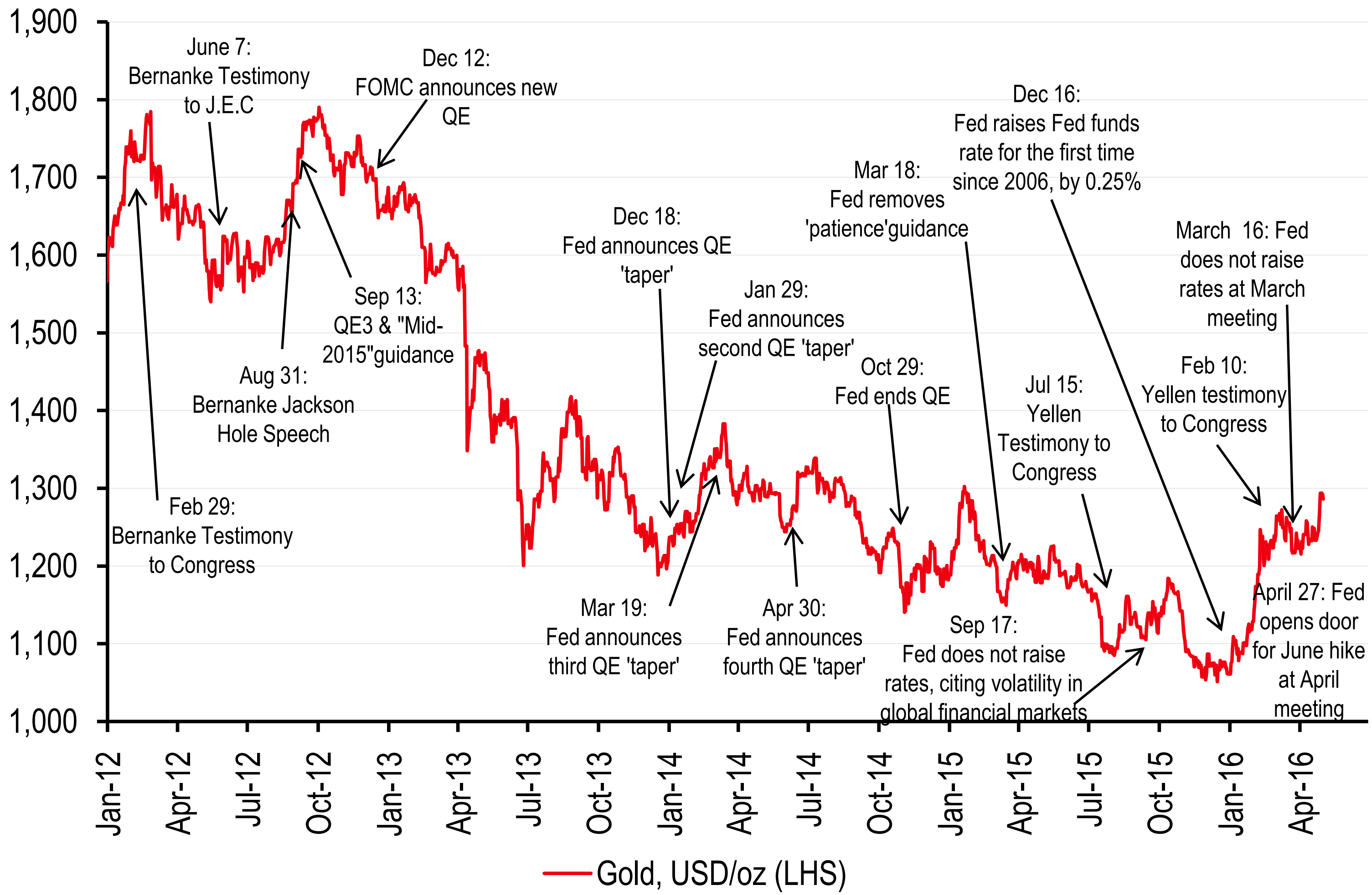


World events and gold



Source: Bloomberg, HSBC

The Fed and gold



Source: Bloomberg, HSBC

Gold recovery

- **USD rally challenged in 2016**
  - HSBC forex strategy team suggests a weaker USD in 2016
  - USD tends not to rally after Fed raises interest rates; gold tends to rally
  - Negative interest rates a positive for gold
  - Market expectations of Fed rate rises weighed on gold in 2013 and 2014; fewer-than-expected rate rises are leading to gold recovery
- **Investment shift**
  - Marked recovery in gold ETFs
  - Rebuilding long positions on Comex
- **Physical market reacting to higher prices**
  - A significant discount in India to world prices, implying no import demand
  - Indian authorities increased taxes on gold jewelry
  - Coin and bar demand volatile in China
  - Room is open for central bank gold purchases if USD is seen as weakening but forex holdings are falling
- **Supply constraint**
  - Gold mine production likely topping out; 2015 may be peak year
  - Scrap market is down due to low prices

Negative rates

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The new trend for some central banks

Highly supportive of gold based on:

- Distress
- Lack of opportunity cost
- Flat yield curve
- Substitute for cash
- “Safe-haven” appeal
- Central bank intervention free

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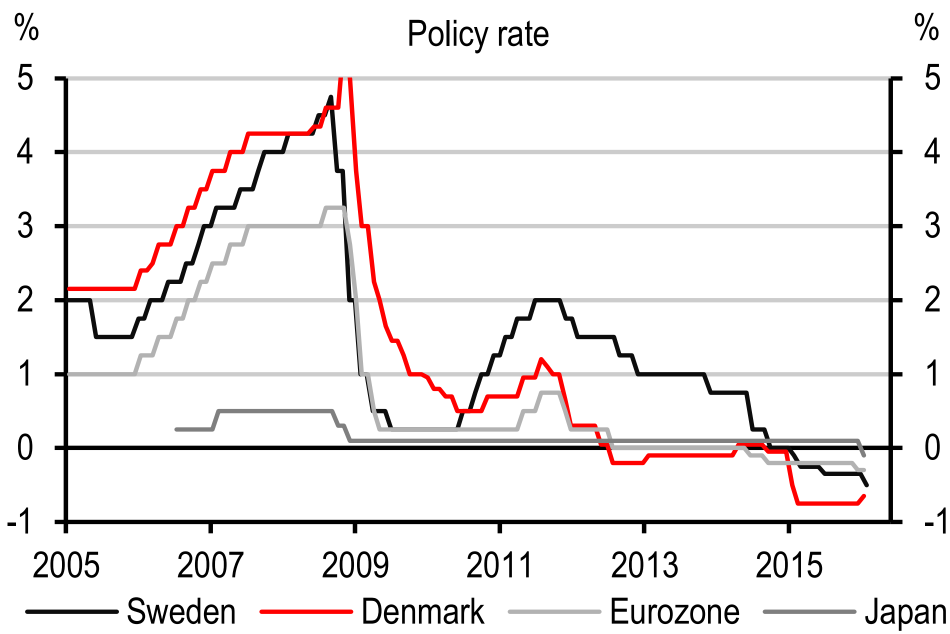
More central banks have breached the zero bound



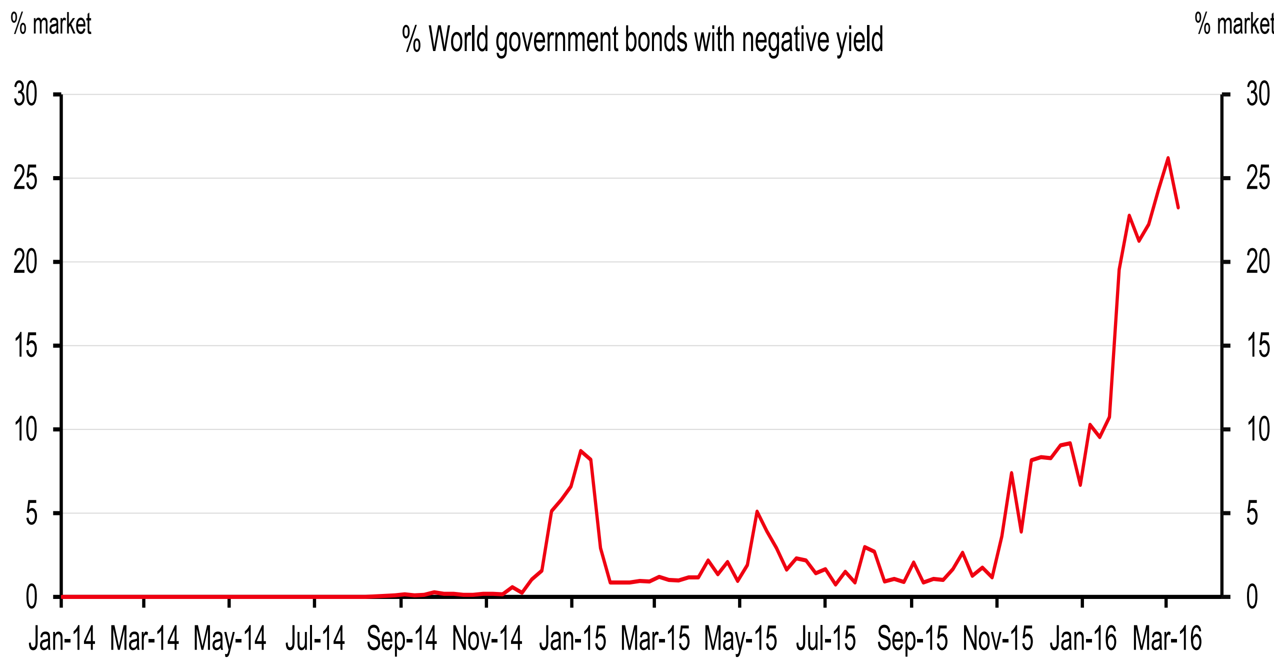
Source: Thomson Reuters Datastream

Global bonds

Roughly a quarter of global government bonds now have a negative yield

Gold began its current rally as the percentage of negative bonds increased

Global bonds with negative yield



Source: HSBC, Bloomberg. Note: Share of Bloomberg global government bond index with a yield to maturity of less than 0%, calculated using amount outstanding.

Gold and rate hikes

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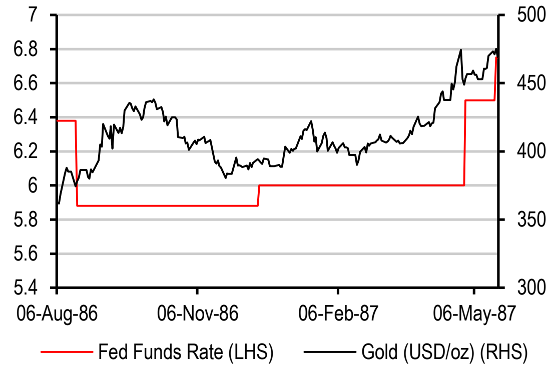
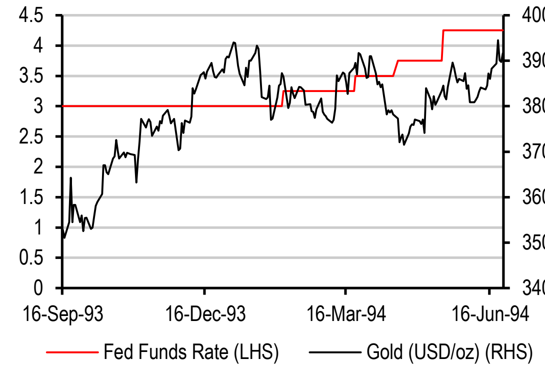
Based on the last four Fed tightening cycles, gold prices tend to weaken going into rate hikes and then rally for the next 120 trading days

December 1986 rate hike



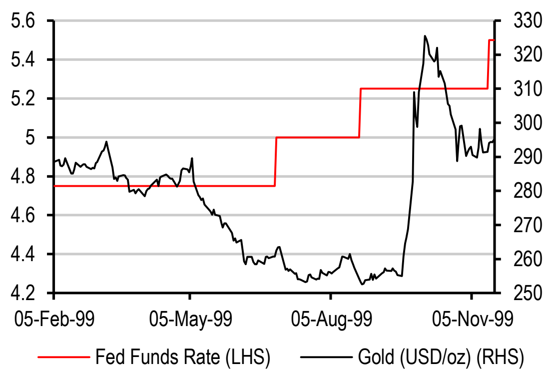
Source: Bloomberg, HSBC

February 1994 rate hike



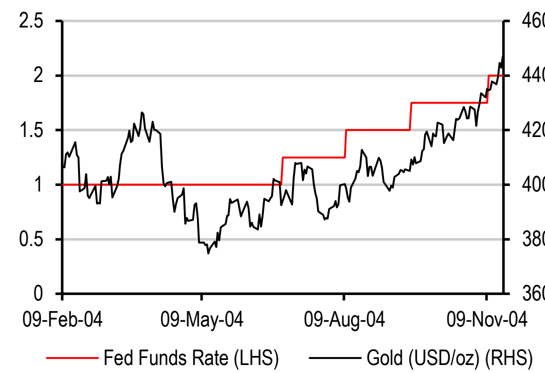
Source: Bloomberg, HSBC

June 1999 rate hike



Source: Bloomberg, HSBC

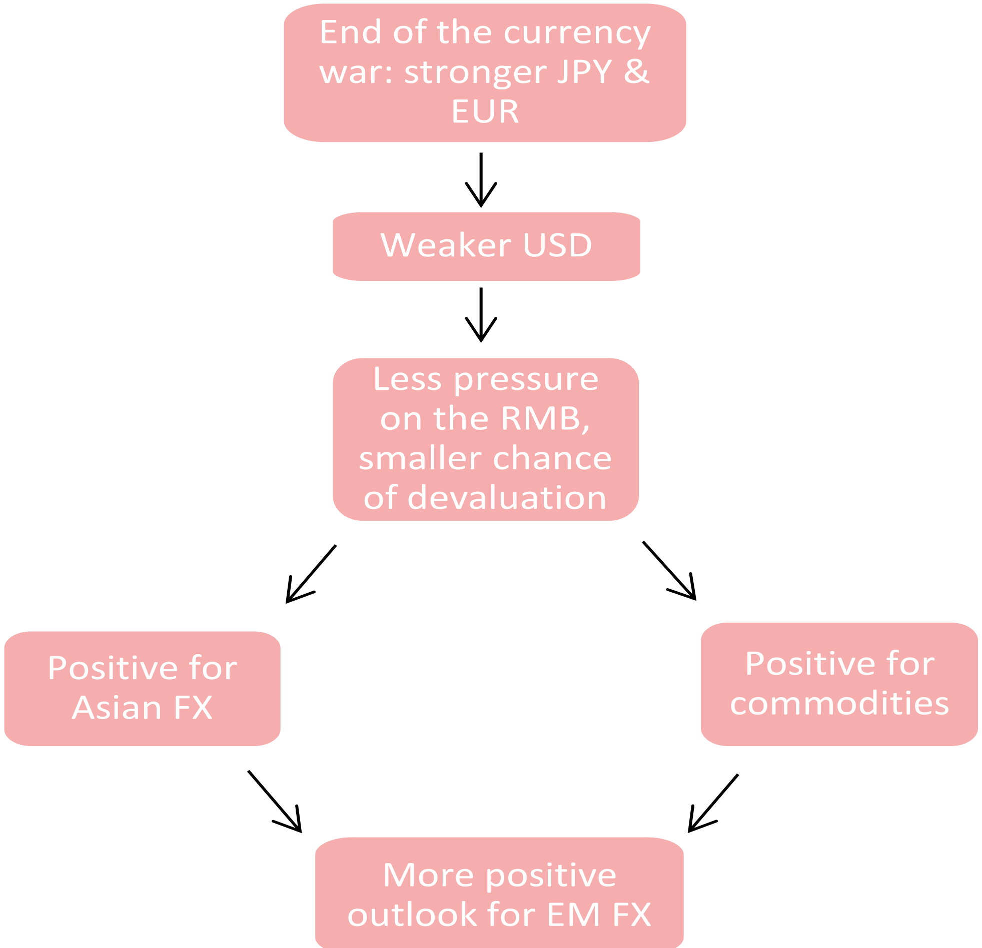
June 2004 rate hike



Source: Bloomberg, HSBC

Currency wars: give peace a chance

The end of the 'Currency Wars' as suggested by the HSBC forex research team is a positive for commodities, including gold



Source: HSBC

Dollar strength scenario

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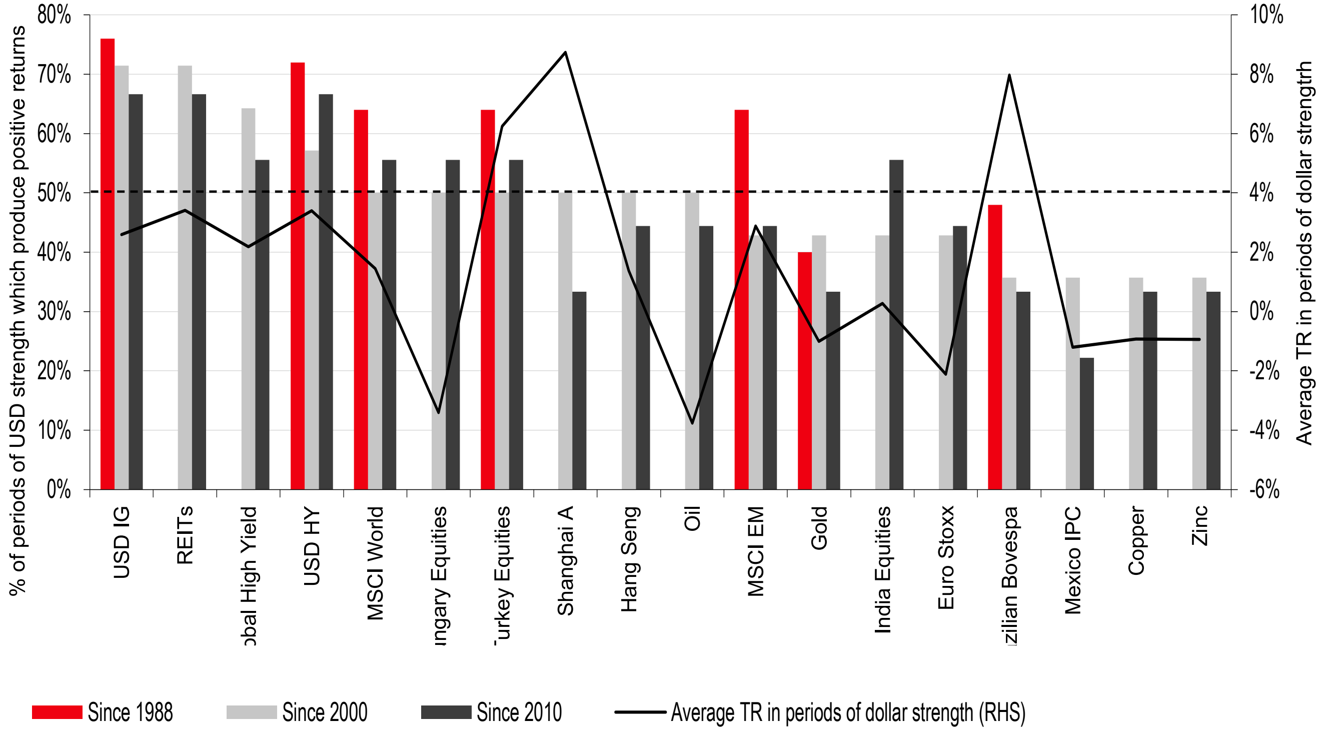
Investment-grade credit, REITs and high yield do well in periods of dollar strength while commodities (including gold) and certain equity markets suffer

Effect of USD strength on assets



Source: Bloomberg, HSBC, Thomson Reuters Datastream

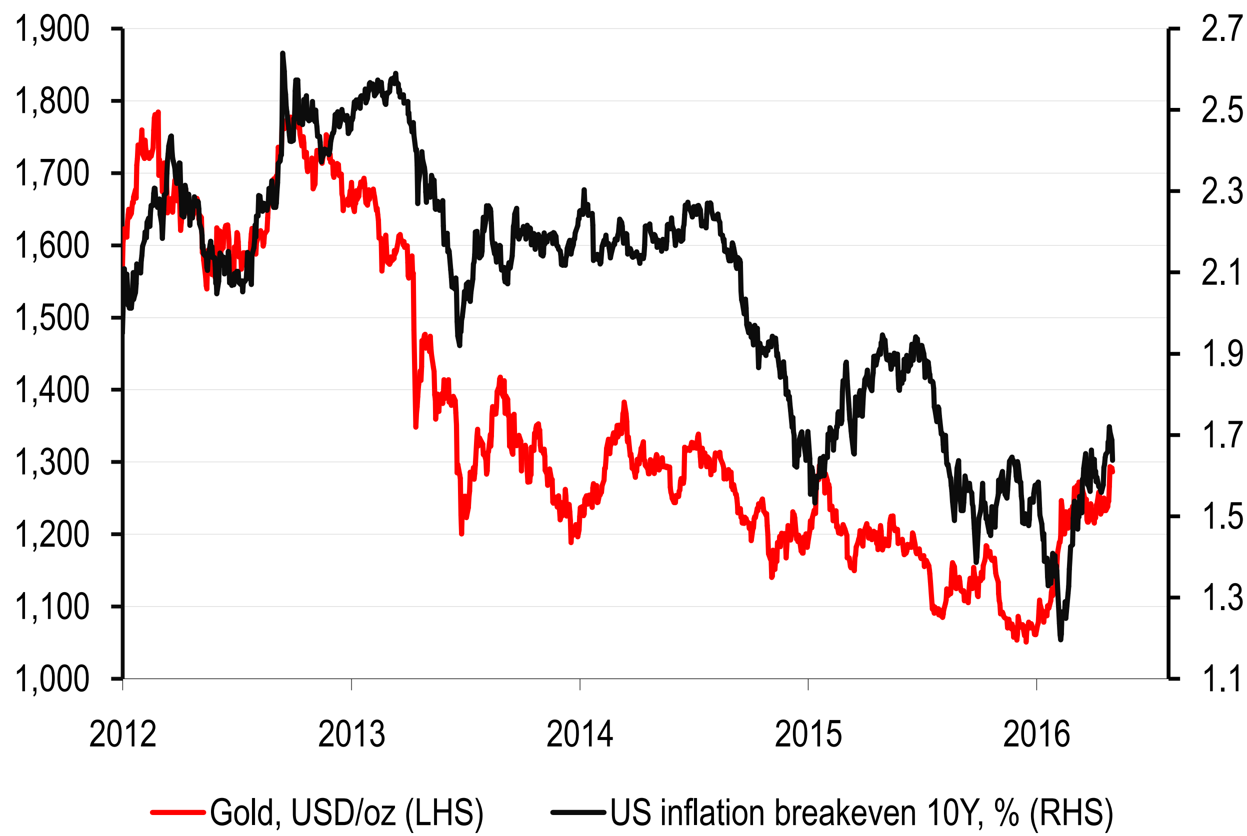
Gold and inflation breakeven

Gold fell in the absence of inflationary pressures

A turn higher in expectations may lend some support to gold

More important, low inflation expectations trigger expectations of easy monetary policy, which supports bullion

Gold moves with inflation expectations



Source: Bloomberg, HSBC

Gold and China's stock market

Equity strength weakened gold

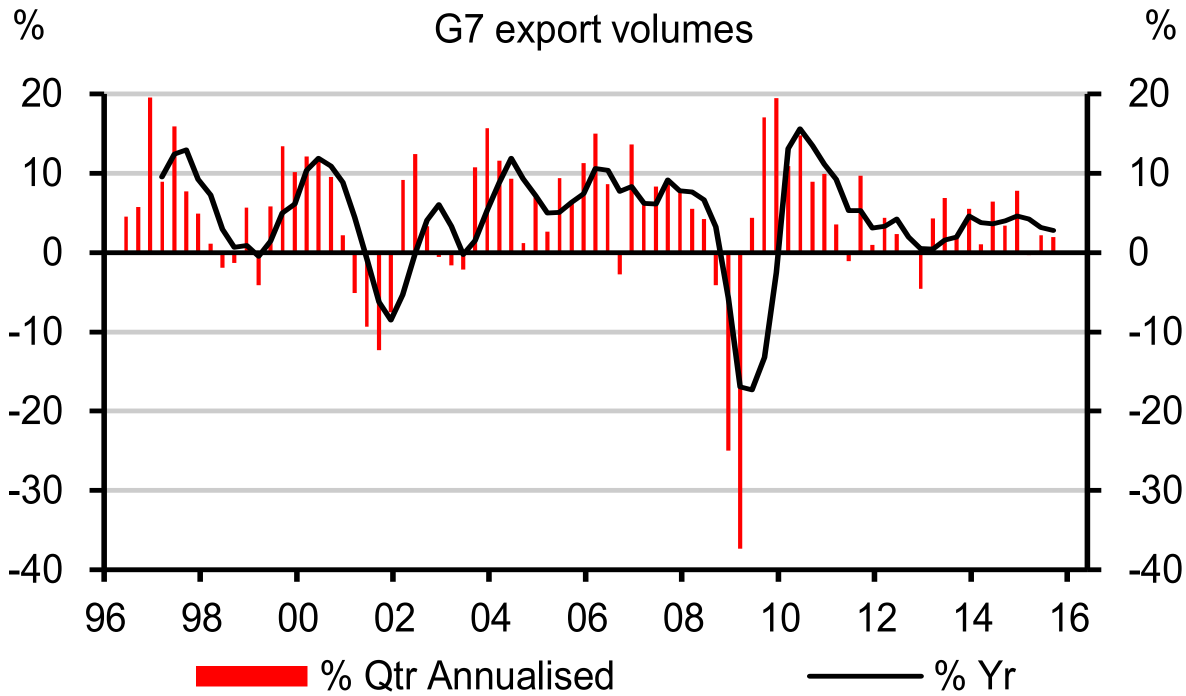
Eventually, equity declines rekindled interest in gold

Source: Bloomberg, HSBC

Global trade

Global trade remains weak

Gold prices tend to have an inverse relationship with world trade patterns



Source: HSBC, Thomson Reuters Datastream

Gold tracks economic policy uncertainty

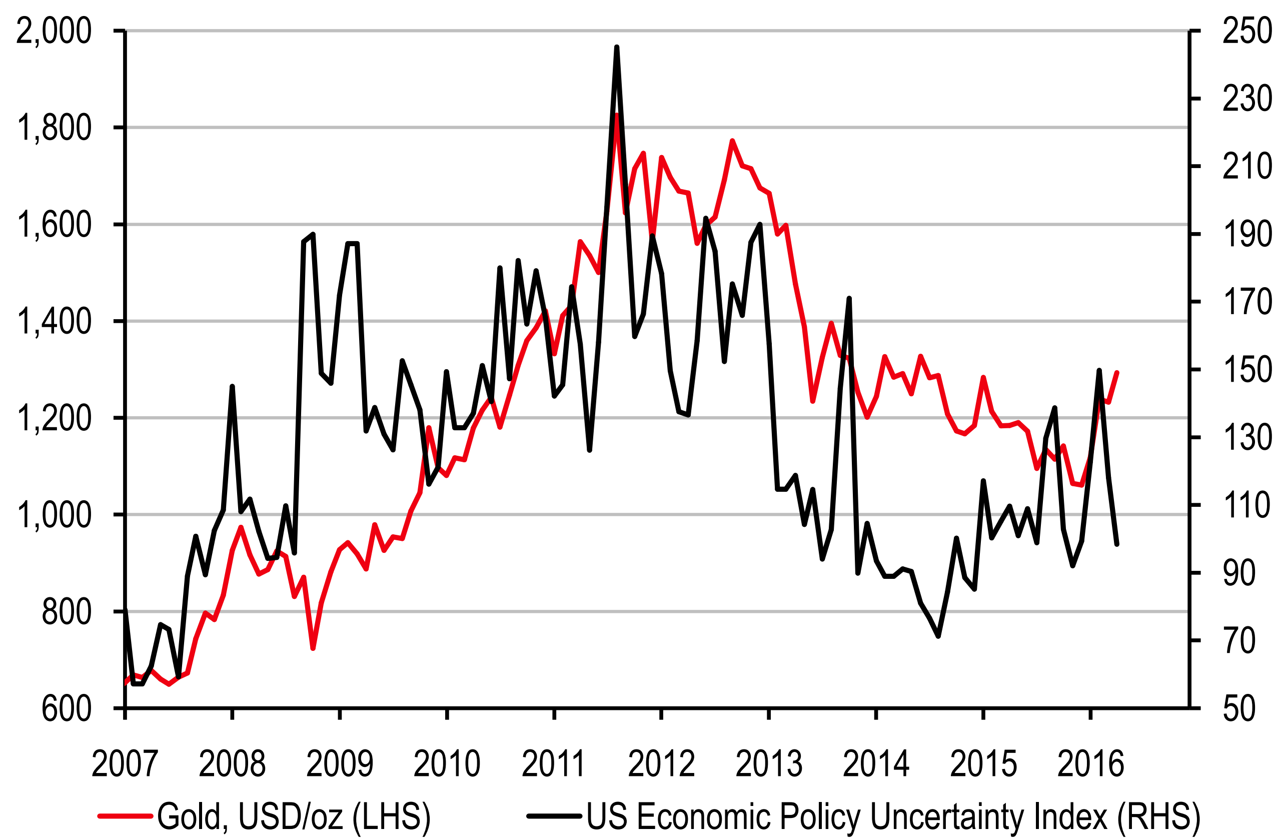
Gold tracks economic uncertainty

The Economic Policy Uncertainty Index rose during the crisis

Gold also rose as rising uncertainty triggered bullion demand

Both peaked in the same month and eased lower until this year

Economic policy uncertainty index and gold



Source: HSBC, Bloomberg

Commodity prices

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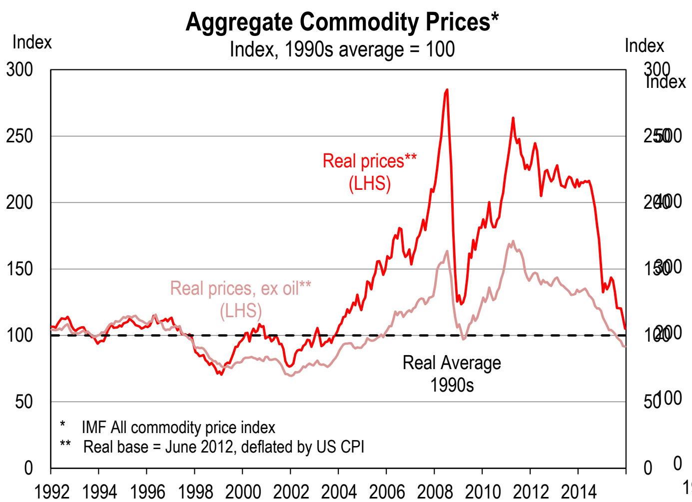
The sharp fall in oil prices over the past 18 months has brought aggregate global commodity prices back to the 1990s average level, when adjusted for inflation

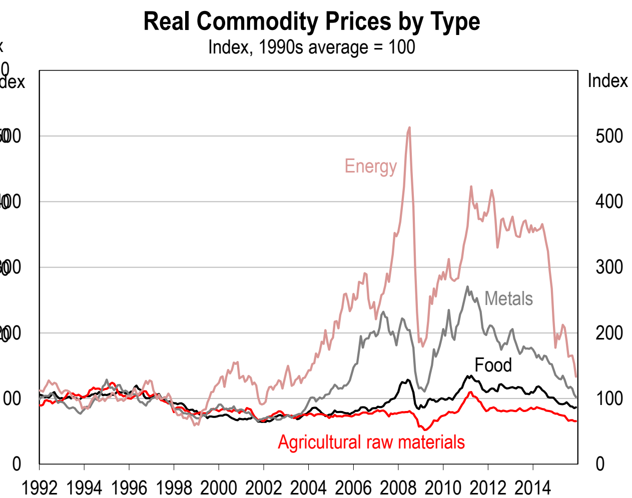
The 12-year ‘super-cycle’ has now run its full course

A recovery may lend support to gold

Real commodity prices at 1990s levels



Energy and metals are down sharply



Source for charts: Thomson Reuters Datastream, HSBC

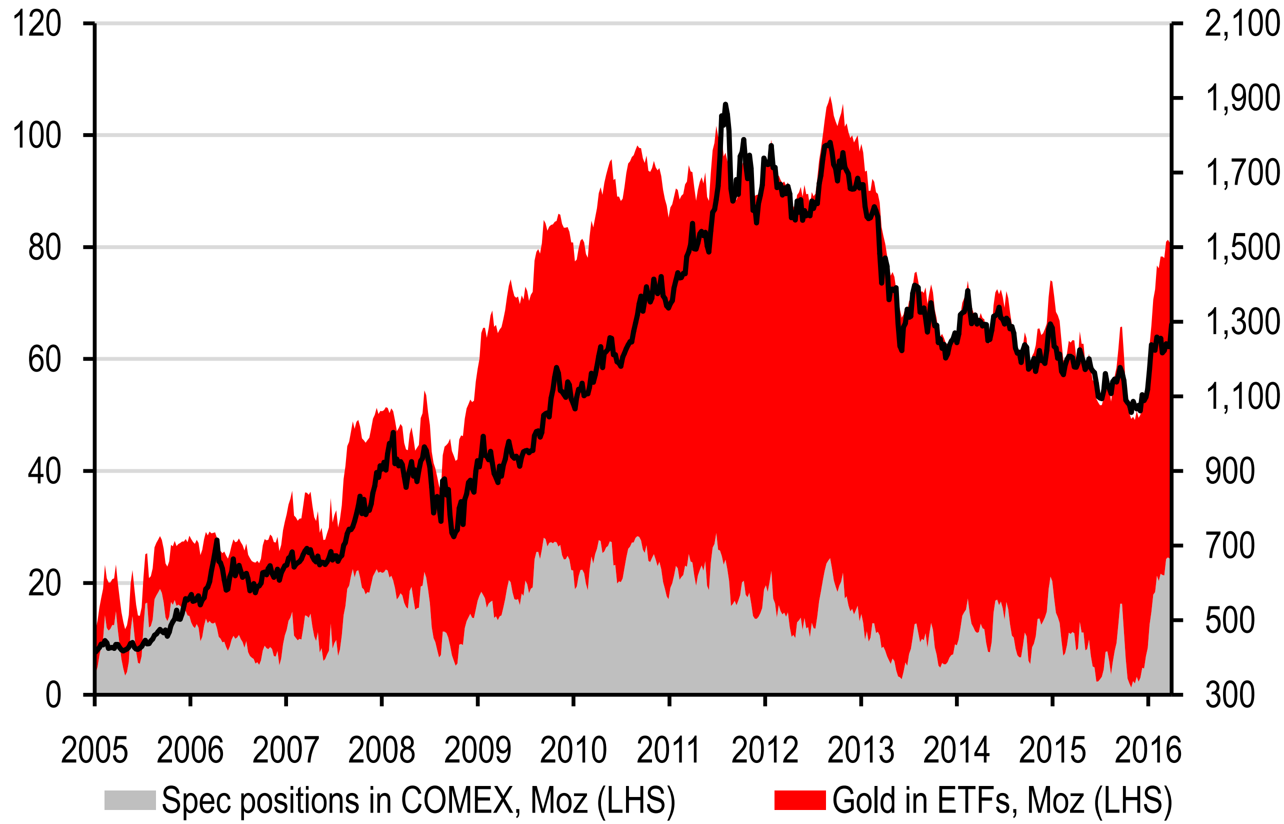
Gold and investments

The decline in investment is seen clearly by the drop in ETF holdings

Declines have reversed as risk-off has encouraged gold purchases

ETFs are rebuilding and we look for further build in 2016 based on risk-on and “safe-haven” demand

Gold and investments



Source: Gold Bullion, ETF Securities, Bloomberg, CFTC, HSBC

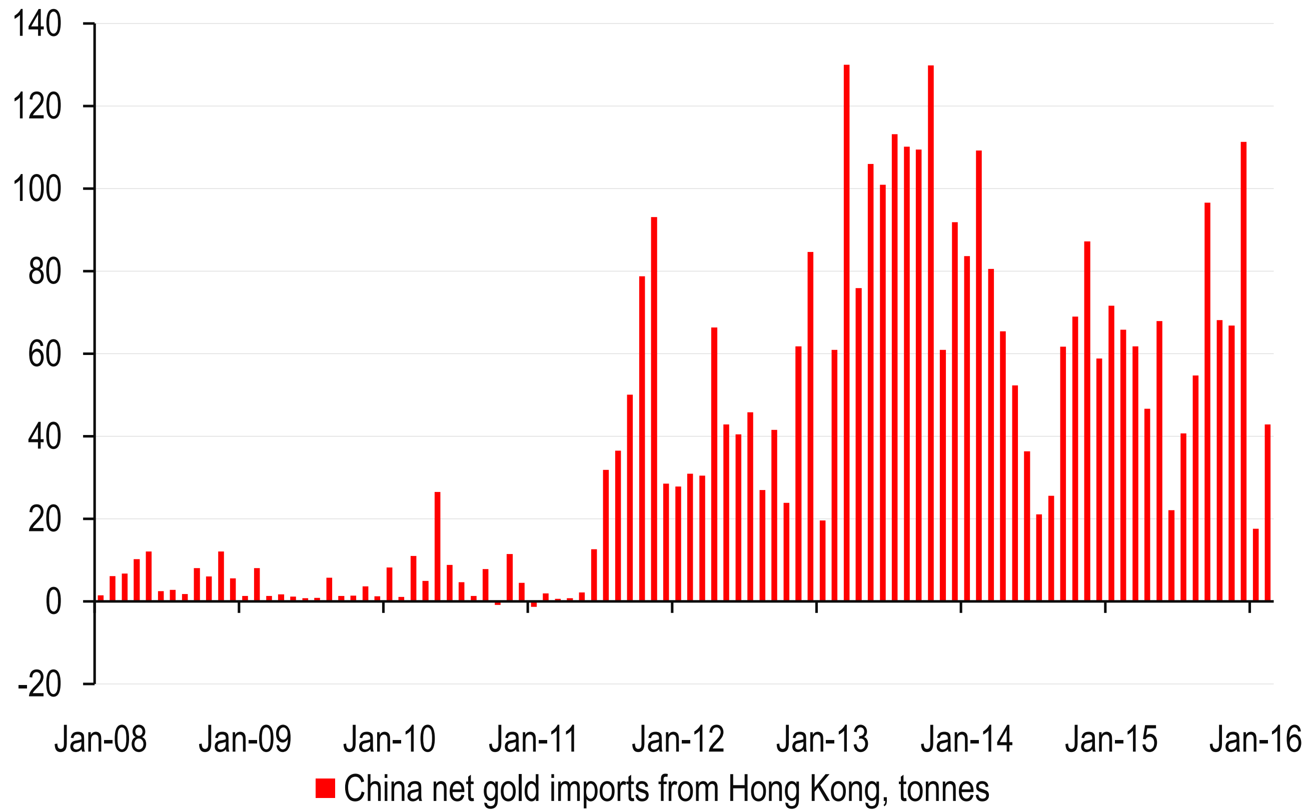
China's gold import from Hong Kong

The drop in prices in 2013 set off a wave of demand in price-sensitive gold-consuming nations

Lower prices at end-2014 stoked demand

Demand has softened more recently but remained historically high until this year

China: Gold imports from Hong Kong



Source: Hong Kong Census and Statistics Department

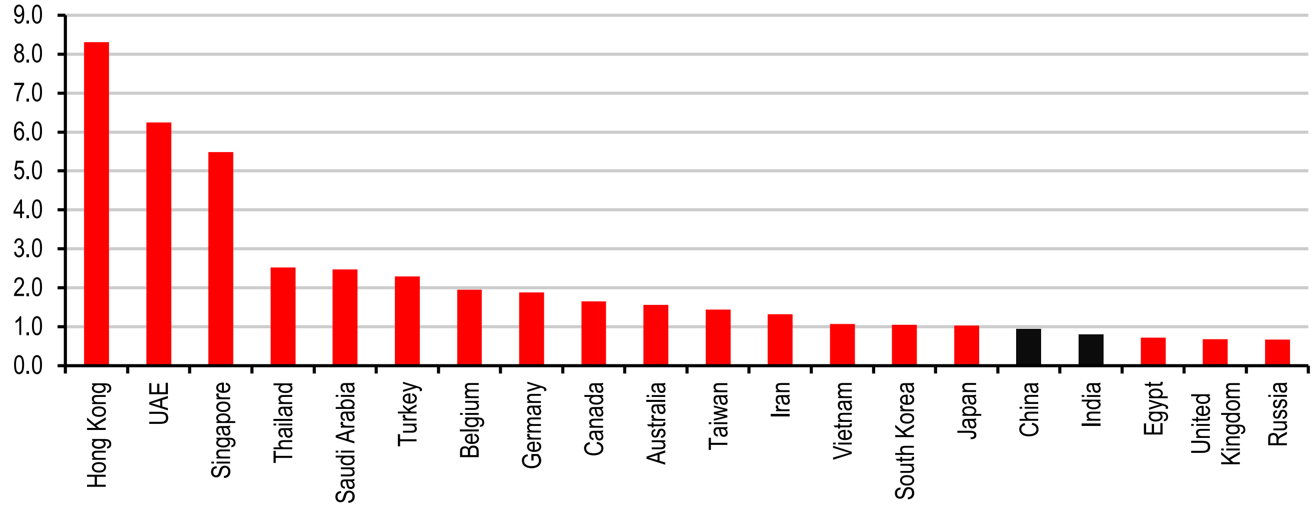
Gold consumption

India and China are the world's two largest gold consumers

However, gold consumption per capita is still relatively small, with plenty of room for expansion

Economic growth and rising wages are the driving forces behind our expectation for India's gold demand to rise in the long term

Gold consumption per capita



Source: Thomson Reuters GFMS

Gold as a percentage of currency reserves among largest holders

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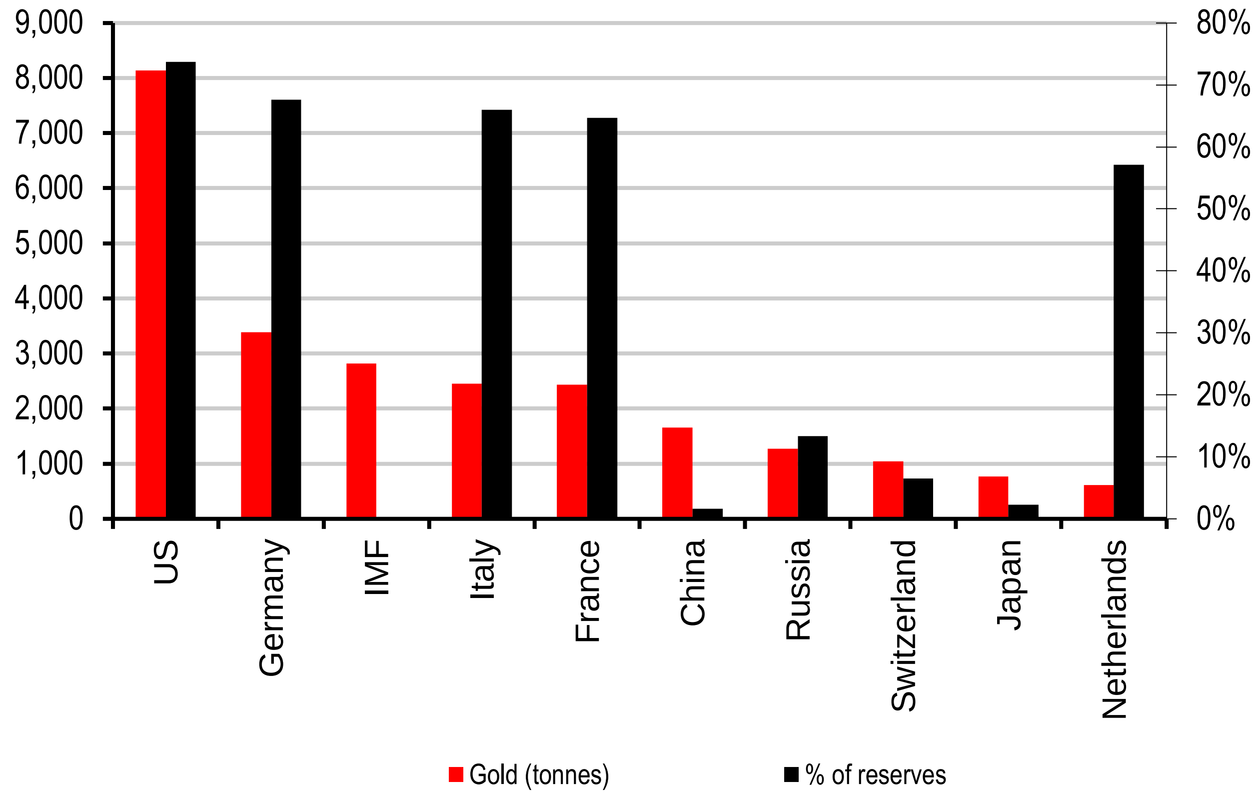
Western central banks hold a large percentage of their foreign exchange reserves in gold

Most other countries have smaller allocations of gold in their foreign exchange reserves

Emerging market central banks are net buyers, while Western central banks have effectively stopped selling gold

China is the second-largest importer of gold and the largest producer

Gold as a % of currency reserves



Source: WGC/IFS

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