Global Precious Metals Comment

Gold may be looking beyond next Fed move

FX

Global

Joni Teves
Strategist
joni.teves@ubs.com
+65-6495 6851

Looking beyond the horizon

Gold's resilience after the employment report is not evidence that rates no longer matter. Rather, it suggests that the market has already absorbed a substantial tightening in expectations and is placing greater weight on why investors want gold in the first place. We would expect a September hike to generate a knee-jerk correction, but not to derail the broader recovery. A hold would likely deliver a stronger upside response. With seasonal demand approaching, official-sector buying continuing and Chinese investment channels supportive, we think the risk-reward into year-end is increasingly skewed to the upside.

Risks are two-sided, but asymmetric to the upside

It is "back-to-school" season and market participants are gearing up for the remainder of the year, facing an abundance of uncertainty. Looking ahead, we expect gold prices to be volatile, yet risks are increasingly skewed to the upside. If the Fed hikes in September, the first move in gold is likely to be lower as real rates and the dollar respond. We would expect that decline to be contained, however. Seasonal physical demand should improve, while institutional and official-sector investors looking to build strategic positions are likely to become more active at lower prices. Alternatively, under a no-hike outcome, investors are likely to chase the metal higher, particularly if the decision were seen as increasing the risk of a policy misstep or reviving questions around Fed independence. In that scenario, the near-term rates relief would combine with the longer-run diversification argument, creating scope for a more forceful move higher than the likely decline under a hike. Put differently, gold may still be vulnerable to hawkish surprises, but it appears increasingly more sensitive to positive catalysts.

Official sector buying is intact

The latest available official sector data shows that although the aggregate numbers are softer than last year, reserve managers continue to add gold at historically meaningful rates and reinforce the pattern of buying into lower and/or more stable prices. In August, China added another ~20 tonnes, bringing the country's total purchases to ~80 tonnes so far this year. The past couple of months have seen the strongest purchase volumes from China since late 2023. Recent reports that Uruguay has also added to gold reserves reflects the broadening of interest within the official sector. The rest of incoming August data will therefore be important less for the exact monthly total than for the signal it sends. Strong reported purchases would reassure investors that official demand can continue to support the market amid headwinds from expected Fed tightening. Other headlines over the past week included the Dutch central bank's (DNB) decision to move around 85 tonnes of gold from the US and Canada to London. We think this is in line with broad trends within the sector and should not have an impact on prices.

Seasonal demand should help

Meanwhile, trading activity onshore in China showed tentative signs of picking up, with turnover of gold futures and forwards edging higher in the past couple of months. Gold ETFs have also been gradually rebuilding and are not far from the highs reached earlier in the year. Import volumes have stayed elevated, despite very muted volumes in physical spot contracts on the Shanghai Gold Exchange. Investment demand across different segments alongside inventory building has likely helped buoy gold shipments to China, especially with the Asian region more generally gearing up to become more active hubs of the global gold trade. As peak gold demand season approaches in India, consumers continue to face headwinds from high prices despite underlying interest remaining strong. Absolute volumes are likely to stay constrained relative to historical levels, though we still expect an improvement from the previous quarter.



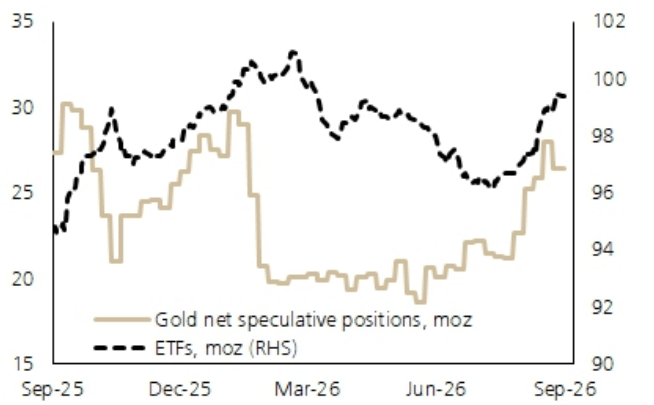
This report has been prepared by UBS AG, Singapore Branch. **ANALYST CERTIFICATION AND REQUI**
INCLUDING INFORMATION ON THE QUANTITATIVE RESEARCH REVIEW PUBLISHED BY UBS, BEGIN ON

Figure 1: US rates continue to matter, although maybe less so than in previous cycles



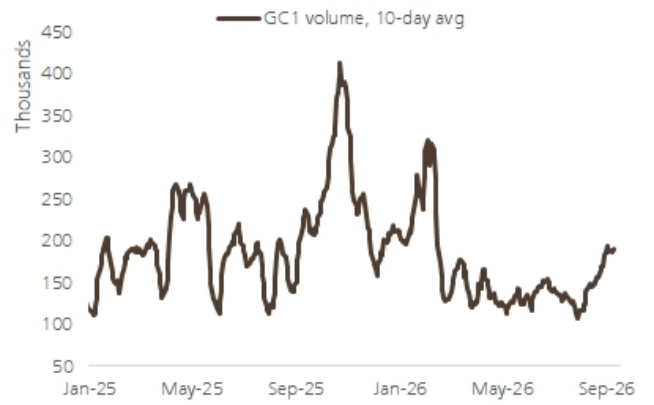
Source: Bloomberg, UBS

Figure 2: Net speculative long futures positions were washed out as Fed rate hikes repriced, but ETF holdings have been relatively resilient



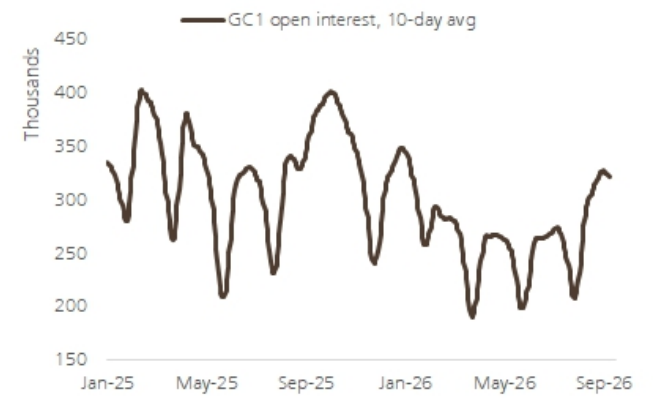
Source: Bloomberg, CFTC, various funds, UBS

Figure 3: Futures trading volumes are up from the summer lows



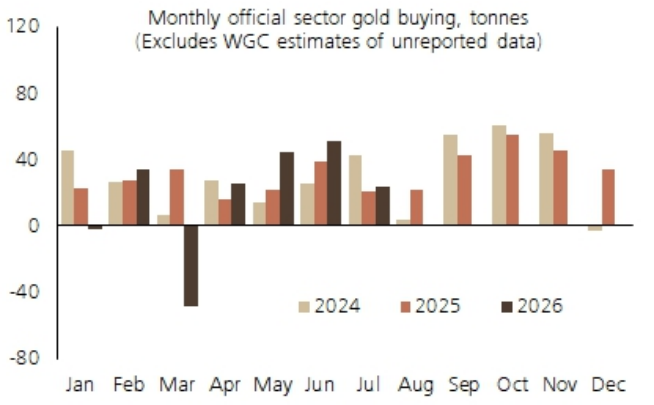
Source: Bloomberg, CME, UBS

Figure 4: Futures open interest was down ~380koz over the past week, likely driven by longs cutting positions



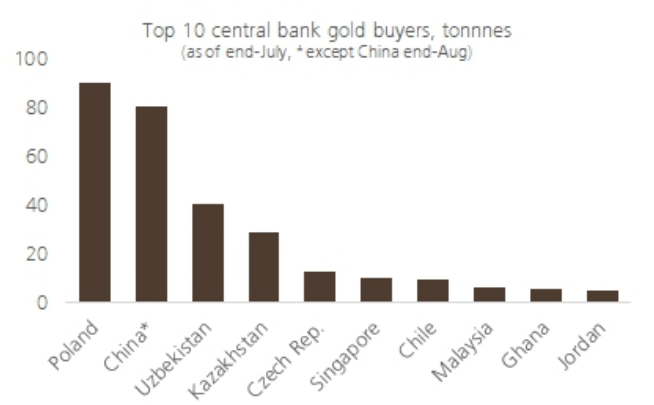
Source: Bloomberg, CME, UBS

Figure 5: Latest data shows central bank purchases eased in July; Net identifiable flows to end-Jul are down ~31% y/y



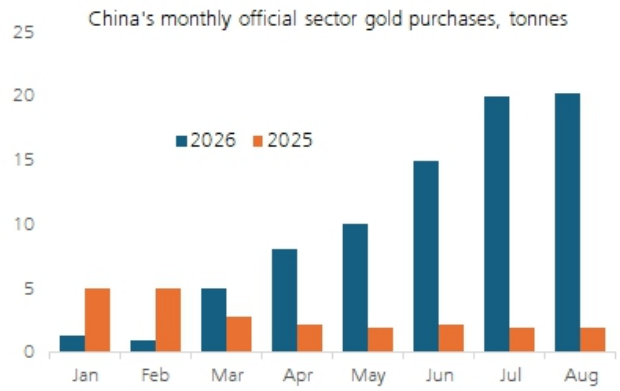
Source: Bloomberg, IMF, WGC, UBS [Monthly Precious Metals Data Summary]

Figure 6: Broadening official sector interest is reflected in the changing mix of top central bank gold buyers over the years



Source: Bloomberg, IMF, WGC, UBS

Figure 7: China added another ~20 tonnes in Aug; purchases in Jul and Aug were the strongest since late 2023



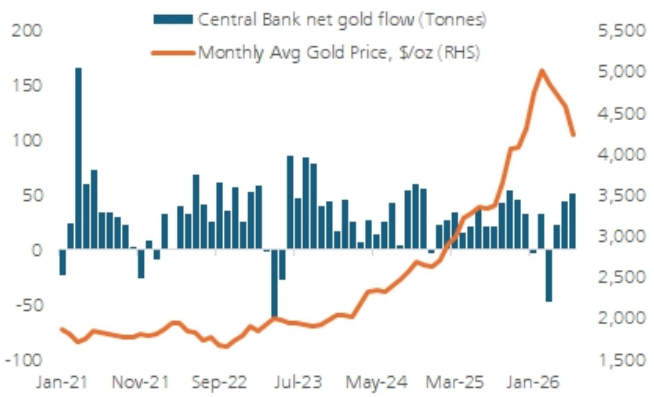
Source: Bloomberg, IMF, WGC, UBS

Figure 8: China resumed purchases in Nov 2022 after a long pause; purchases stepped up again in March this year, coinciding with the decline in gold prices, though volumes held in Aug despite the rally



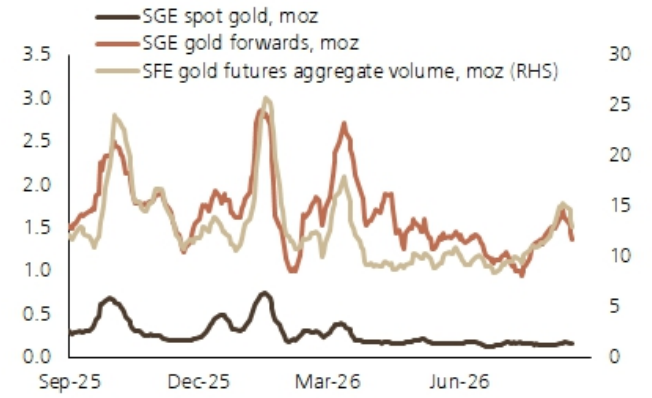
Source: Bloomberg, IMF, WGC, UBS

Figure 9: Aggregate central bank purchases are affected by gold prices as well as changes in the composition of buyers



Source: Bloomberg, IMF, WGC, UBS

Figure 10: Trading volumes of gold futures & forwards in China has improved of late, though currently off the recent highs; physical spot turnover has remained muted



Source: Bloomberg, SGE, SHFE, UBS

Figure 11: Gold ETFs in China have been gradually edging higher, up by ~600koz in July-August and by 1.6moz YTD



Source: Bloomberg, various funds, UBS

Gold has held up remarkably well in the face of a much stronger-than-expected US employment report and a renewed repricing of Fed tightening risk. UBS US economists now expect two 25bp hikes this year, at the September and December FOMC meetings. The metal's relatively muted response so far is telling. Some tightening has been discounted for some time, but more importantly, investors appear increasingly willing to look beyond the next data release and the immediate opportunity cost of holding a non-yielding asset. The conversation is shifting back toward the medium- and long-term role of gold as a way to make portfolios more resilient against an unusually broad mix of macroeconomic, policy and geopolitical risks.

Resilience is the message

A conventional reading of the latest macro news would have pointed to a sharper correction. August payrolls rose by 162,000, almost three times the consensus estimate, and markets have lifted the probability of a 25bp September hike to around 62%. Yet gold has absorbed the shock well so far. That suggests the rates story is not operating in isolation. To be sure, investors still care about real yields and the dollar, but they are also asking what is driving higher rates, how durable these will be and what it means for growth, fiscal credibility and the wider policy framework. This distinction matters. A hike delivered against a backdrop of high inflation driven by accelerating growth will be challenging for gold. This is not the case currently.

The market's ability to hold up indicates that a meaningful part of the adjustment in Fed expectations has already taken place. It also reinforces our sense that strategic investors are treating setbacks less as a reason to abandon exposure and more as a chance to improve entry levels.

The year-end risk distribution is tilting higher

In this "back-to-school" season, market participants are gearing up to face and abundance of uncertainty. For gold, we think the balance of risks is becoming more favourable. If the Fed hikes in September, the first move in gold is likely to be lower as real rates and the dollar respond. We would expect that decline to be contained, however. Seasonal physical demand should improve, while institutional and official-sector investors looking to build strategic positions are likely to become more active at lower prices. The result may be a pullback that is sharp enough to attract attention, but not deep or persistent enough to change the broader direction.

In contrast, a no-hike outcome would produce a more asymmetric response, in our view. Investors are likely to chase the metal higher, particularly if the decision were seen as increasing the risk of a policy misstep or reviving questions around Fed independence and credibility. In that scenario, the near-term rates relief would combine with the longer-run diversification argument, creating scope for a more forceful move higher than the likely decline under a hike. Put differently, gold may still be vulnerable to hawkish Fed action and surprises, but it appears increasingly sensitive to positive catalysts.

Official sector and seasonal physical demand should help cushion the blow

The latest available official-sector data shows reported net purchases of ~23 tonnes in July, taking year-to-date identifiable buying to around 125 tonnes versus roughly 182 tonnes over the same period last year. Though the aggregate numbers are softer than last year, they still show that reserve managers are adding gold at historically meaningful rates and reinforce the pattern of buying into lower and/or more stable prices. In August, China added another ~20 tonnes, bringing total purchases to ~80 tonnes so far this year. The past couple of months have seen the strongest purchase volumes from China since late 2023. Poland remains the leading reported buyer with 90 tonnes as of end-July.

The rest of incoming August data will be important less for the exact monthly total than for the signal it sends. Strong reported purchases would reassure investors that official demand can continue to support the market amid headwinds from expected Fed tightening. Even a more moderate number would not undermine the structural story, in our view, provided the breadth and continuity of buying remain intact. Recent reports that Uruguay has added gold this year for the first time in around 30 years is another

indication of this broadening of interest within the official sector. The rest of incoming August data will therefore be important less for the exact monthly total than for the signal it sends. Strong reported purchases would reassure investors that official demand can continue to support the market amid headwinds from expected Fed tightening. Other headlines over the past week included the Dutch central bank's (DNB) decision to move around 85 tonnes of gold from the US and Canada to London. We think this is in line with broad trends within the sector and should not have an impact on prices. It highlights increasingly deliberate considerations about where gold is held and an increasing acknowledgment of gold's relevance as an asset that can be used effectively under certain scenarios. These themes are also echoed in our conversations with institutional investors and the private wealth community.

China's demand looks mixed, but constructive

Activity onshore in China appears mixed - while gold futures and forwards did show an uptick in recent months, physical spot trading volumes have remained muted. Import volumes remained elevated despite subdued wholesale demand on the Shanghai Gold Exchange. Meanwhile, Chinese gold ETFs have been edging higher, attracting inflows of around 19 tonnes in July and August, with the positive trend continuing into this month. Total ETF holdings in China currently sit around 305 tonnes as of early September.

That combination points to a market in which investment flows and inventory rebuilding are doing more of the work, while jewellery demand volumes remain restrained by high absolute prices. It is a useful evolution: demand is becoming less dependent on any one channel. Over the long run, Asia’s growing role in global gold trading, investment and physical distribution could increase the region’s influence on global price discovery and eventually deepen the pool of liquidity during the time zone. This could open up more access for investors which we think should ultimately be positive for long-term investment demand.

Valuation Method and Risk Statement

Risks of multi-asset investing include but are not limited to market risk, credit risk, interest rate risk, and foreign exchange risk. Correlations of returns among different asset classes may deviate from historical patterns. Geopolitical events and policy shocks pose risks that can reduce asset returns. Valuations may be adversely affected during times of high market volatility, thin liquidity, and economic dislocation. All options discussions are 'over-the-counter'. Losses on some options trades are potentially unlimited unless hedged/neutralised.