# Gold prices: Not breaking the range in the near-term

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## Gold prices remain range bound reflecting conflicting factors but the underlying environment remains supportive

After touching a record high of USD 2000/oz, gold prices have shown signs of consolidating but have not broken below a key support level of USD 1900/oz. The underlying environment continues to remain favourable with the FOMC moving to a flexible average inflation targeting regime. The new regime would entail that the Fed allows for inflation overshoots in the medium to longer-term raising the demand for an inflation hedge such as gold. Secondly, the global risk environment has remained somewhat challenged as global equity markets have been volatile but corrected lower over the last month reflecting uncertainty about the outlook as second wave of infections have picked up. Other policy related uncertainties such as those related to 'US fiscal policy' and 'Brexit' worked as additional support for gold prices.

At the other end of the spectrum has been a rebound that has taken place in the USD primarily against the GBP. USD strength has worked to restrain sharp upside in gold prices. Lastly, investors are continuing to respond to news on the vaccine developments that is adding to intra-day volatility for gold prices. Some signs of progress are working to lower the uncertainty premium of gold prices.

**In short, gold prices remained volatile but within a range as investors responded to diverging drivers.**

## Economic growth: Still fragile supporting gold prices

An emerging theme has been the sequential moderation in the pace of global recovery in August, indicating that a U-shape recovery is taking place rather than faster V-shape recovery that was getting priced in about a month back. The slower pace of sequential increase is visible in the PMI surveys that were released. Another emerging concern is the slowing in growth momentum in the Euro-zone that was visible in industrial production release as well as retail sales figures for July that slowed on a sequential basis. Besides, the moderation in consumer and business confidence in Europe, the US and Asia for August have re-enforced the theme of slowing in the pace of recovery globally. The only real upside surprise has come from a sharp fall seen in the US unemployment rate, although it still remains well above the full-employment level.

In short, the global recovery still remains fragile and that negative output gaps are likely to prevail forcing global central banks to maintain a fairly accommodative framework. **Economic uncertainty combined with policy stimulus continue to work as important structural support drivers for gold prices.**

## Investor demand continues to rise amid market turmoil

**CFTC data:** As per the latest CFTC report, large speculators increased their net bullish positions in gold to 236.5K contracts on 12th September 2020, compared to 230.8 K contracts as on 5th September 2020 and 224.1K as on 15th August 2020, indicating long term bullish trend remains in place.

**ETF holdings:** SPDR Gold Trust holdings, the world's largest gold-backed exchange-traded fund, decreased to 1248 on 11th September 2020 from 1252.38 tonnes on 21th August 2020, driven by modest profit booking. While there some lowering in ETF buying on a sequential basis, the quantum continues to represent ~41% rise on a YoY basis.

## Indian Gold view:

Domestic gold prices have traded marginally lower primarily reflecting exchange rate movements as the USD/INR pair has traded modestly lower. The downward move in the USD/INR pair has come at the same time as global international prices have traded flat. India gold imports more than doubled last month ahead of the start of the key festival season. The imports of gold climbed to 35.5 tons in August-2020 from 14.8 tons in August-2019 and was also higher than the 30 tonnes worth of imports that took place in July-2020. We see a flat trajectory in the near-term.

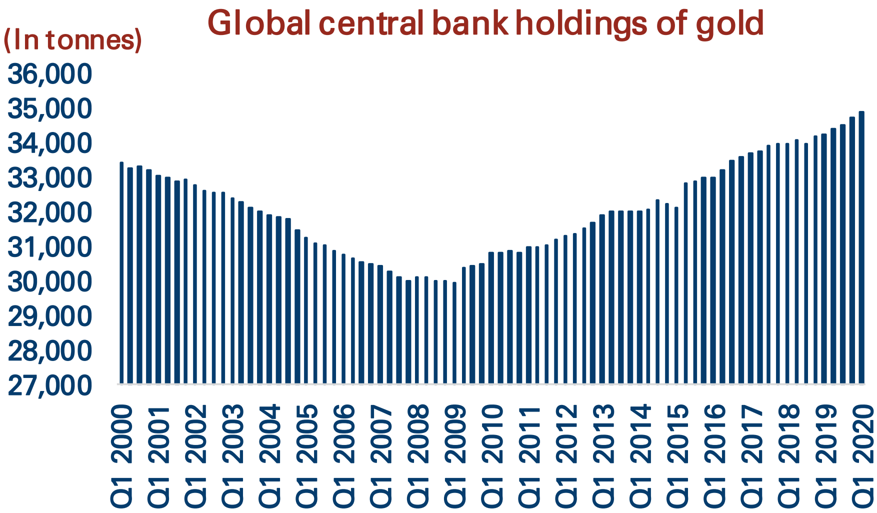
## Indian Rupee view:

The USD/INR pair has moved lower primarily reflecting reduced intervention from the RBI combined with continued capital inflows. Besides, other regional currencies such as USD/CNY and other USD/AXJ pairs (AXJ: Asia excluding Japan) have been trending with a downside bias reflecting a favourable global liquidity environment accompanied by an increase in risk seeking. 'Brexit' related uncertainty is unlikely to have a significant impact on EM FX such as the INR. Only if the UK actually crashes out of the EU will it have a pronounced negative impact via a risk sentiment perspective. We subsequently see the USD/INR pair trading in the 73.00-74.00 range in the near-term with RBI intervention expected at sporadic intervals to restrict a sharp pace of downtrend in the pair.

## The outlook:

**We maintain our bullish outlook on gold prices, even as some degree of consolidation appears to have set in.** The underlying environment of: (a) record monetary and fiscal stimulus, (b) long-term inflation concerns, (c) uncertainty about the outlook, (d) low and negative yields and (e) increase in gold purchases by central banks as part of their reserve diversification process—are all working as important structural support. Hence, we maintain that gold prices are likely to move in the USD 1900/oz to USD 2000/oz range over remainder of 2020 and we see a further upside in 2021. Going forward, we expect the FOMC to reinforce that the monetary policy environment will remain accommodative for a considerable period of time that will work as an important support in the near-term. Some uncertainty about the outcome of the US Presidential elections could also keep up demand for a physical asset such as gold prices.

**Chart 1:** Global central banks demand for gold has increased considerably




*Source: Reuters, & ICICI Bank Research*

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