ABN·AMRO

Precious Metals Watch

Group Economics
Macro & Financial Markets Research

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Relationship broken?

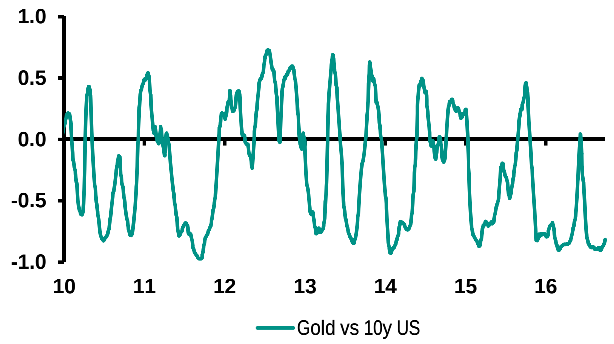
Georgette Boele
Co-ordinator FX & Precious Metals Strategy
Tel: +31 20 629 7789
georgette.boele@nl.abnamro.com

- **Gold prices and 10y US Treasury yields moved lower…**
- **…which is an unusual combination**
- **A modest rise in the US dollar…**
- **…disappointment on the monetary policy front…**
- **…and impatient investors are the main reasons for this**

Gold prices react in an unexpected manner…
Recently, gold prices reacted in an unexpected manner. US Treasury yields moved lower, while gold prices also moved lower. In general, gold prices rise if US Treasury yields decline. This is because lower US Treasury yields in a risk averse environment result in higher demand for assets with safe haven characteristics (gold is among those assets). Moreover, lower US Treasury yields make gold as an asset more attractive to invest in, as it does not have a yield.

Negative relationship between gold and 10y UST yield

90-day rolling correlation

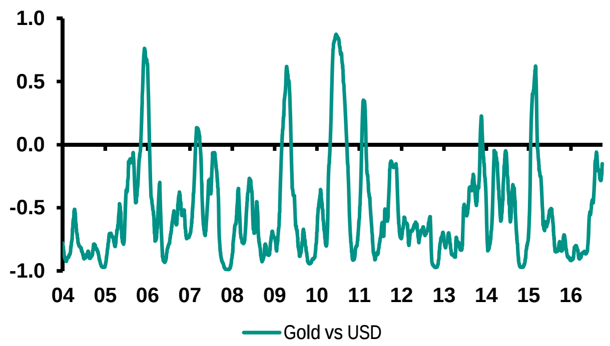


Source: Bloomberg, ABN AMRO Group Economics

Why did gold price behave like this? We think that there are three forces at play. First, the US dollar rose modestly. Gold has a strong negative relationship with the US dollar. This is a dominant driver for gold prices (see graph below).

US dollar dominant driver for gold prices

90-day rolling correlation



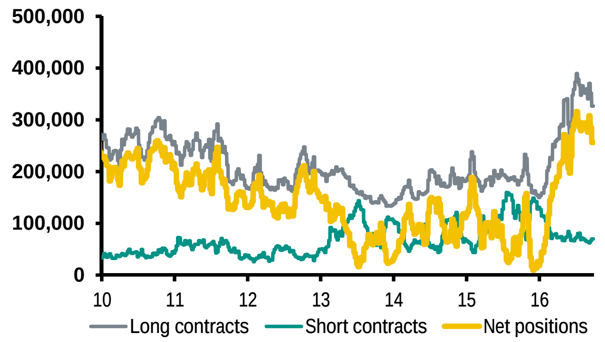
Source: Bloomberg, ABN AMRO Group Economics

Second, the ECB, BoJ and the Norges Bank have been less dovish in their actions and communications compared to market expectations. As a result, this has made the case for gold and silver less strong.

Last but not least, investors are already positioned for higher prices (see graphs below).

Speculative gold positions remain large…

Number of contract

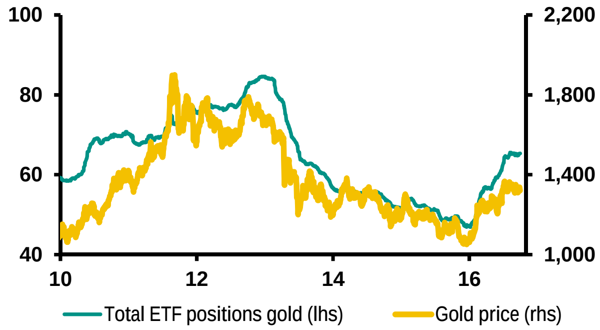


Source: Bloomberg, ABN AMRO Group Economics

… and investors hesitate to build up ETF positions

In mln ounces

Gold price



Source: Bloomberg, ABN AMRO Group Economics

The gold price action over the recent months has disappointed investors. As a result, they have been starting to think that the rise in gold prices is over. It appears that some impatient investors have started to sell gold positions when prices approach USD 1,350 per ounce. The failure of gold prices to stay above USD 1,340 per ounce could have resulted in investors lowering their offers. It is likely that gold prices will first revisit the lower border of the range at around USD 1,300 per ounce. If this level remains in place, gold prices could move back towards USD 1,335-1,340 before the move is losing momentum again. This process of the market testing both sides of the range could continue for a while. But both borders will probably converge until there is finally a breakout. If the lower border is broken, prices could quickly fall towards USD 1,250 per ounce where the 200-day moving average comes in.

Our base scenario remains for gold prices to stay in a USD 1,300-1,350 per ounce for now. Over time (H2 2017) we expect gold prices to break out on the upside for the following reasons:

1. US inflation will likely be higher than growth
2. US real interest rates are forecast to remain negative (less negative though)
3. The longer-term US dollar trend has turned negative

Alternative scenarios

This range will likely be broken earlier if Trump becomes President and/or if investor sentiment deteriorates sharply. This would result in sharply higher gold prices. Another scenario is that US economic growth picks up strongly triggering the Fed to hike rates aggressively in an environment of constructive investor sentiment. This would be a bull case for the US dollar as US real rates would also rise substantially. In this scenario the US dollar uptrend would have another leg while gold prices could drop below their 200-day moving average of USD 1,250 per ounce signalling that the uptrend is over.

ABN AMRO precious metals forecasts

Changes in red/bold

End period	29-Sep	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Gold	1,321	*1,061*	*1,233*	*1,322*	1,325	1,325	1,325	1,350	1,400	1,450
Silver	19.1	*13.9*	*15.38*	*18.48*	19.50	19.50	19.50	20.00	22.00	24.00
Platinum	1,031	*894*	*976*	*1,018*	1,150	1,050	1,000	1,200	1,300	1,400
Palladium	712	*562*	*563*	*597*	700	650	625	650	700	725

Average	Q1 16	Q2 16	Q3 16	Q4 16	2016	Q1 17	Q2 17	Q3 17	Q4 17	2017
Gold	1,181	1,258	1,324	1,325	1,272	1,325	1,338	1,375	1,425	1,366
Silver	14.9	16.8	19.0	19.5	17.5	19.5	19.8	21.0	23.0	20.8
Platinum	975	1,004	1,084	1,100	1,041	1,025	1,100	1,250	1,350	1,181
Palladium	527	568	649	675	605	638	638	675	713	666

Source: ABN AMRO Group Economics

Find out more about Group Economics at: **https://insights.abnamro.nl/en/**

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