

Gold: Breaking out is hard to do

After an incredibly range bound Q1, gold remains in the crossfire of rising bond yields and rate hikes versus growing inflation and trade tensions.

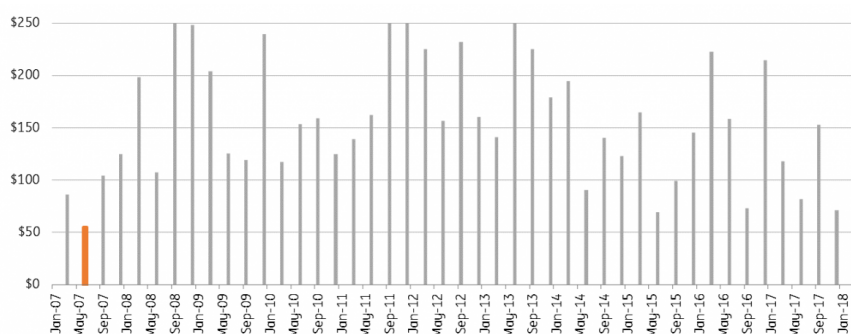


Source: Shutterstock

	2018				2019				2020			
	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Gold	1,336	1,350	1,400	1,375	1,375	1,425	1,400	1,375	1,400	1,400	1,400	1,400
Silver	16.8	18.0	19.5	18.5	18.5	20.0	19.5	19.5	19.5	19.5	19.5	19.5
Platinum	978	940	1,000	1,060	1,060	1,100	1,080	1,100	1,120	1,120	1,120	1,120
Palladium	1,033	960	1,020	1,120	1,090	1,130	1,140	1,160	1,150	1,150	1,150	1,150

Source: ING Research

In Q1 Gold had its most narrow range since 2007 (\$/oz)

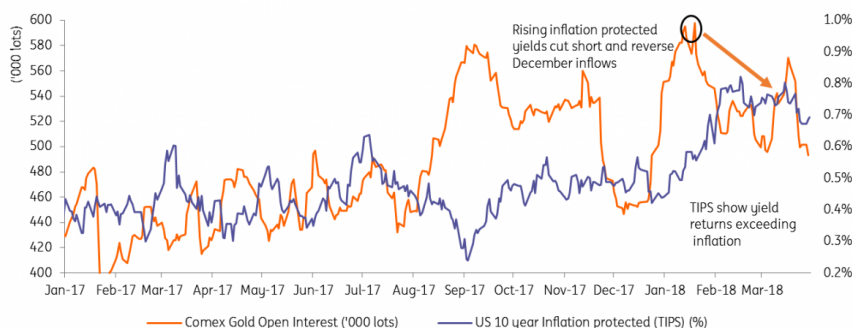


Source: Bloomberg, ING Research

The trend was no one's friend

Gold arguably performed poorly as a safe haven this last quarter but we remain gold bulls with inflation set to turn and more pain for the USD. In Q1 the metal traded with a range of just \$63/oz which is the lowest since 2007. Soaring yields, including for inflation-linked bonds (TIPS), have deterred funds from holding on to long positions and backing any meaningful outbreak in prices. Despite the massive influx of fresh positioning post the December rate hike, only once in early Jan did prices manage to close above \$1360/oz. Since then liquidation has been the general trend as inflation-adjusted yields have picked up alongside the surge in nominal returns. We have [previously suggested](#) such a yield increase points to investors demanding concessions for US holdings, but even so gold has lacked its safe haven allure this quarter, failing to meaningfully break out even through equity turmoils and escalating trade tensions. Tellingly versus the safe haven JPY, gold is down 3% year-to-date.

Gold inflows short lived in competition from real yields



Source: CME, Bloomberg, ING Research

What's got to give?

ING remain bullish gold and expect prices to break out to the upside this quarter, but to do so will require meaningful and sustained inflows. Our bearish view on the dollar and for higher inflation (3% by summer) plays well with gold's traditional features. Swelling ETF holdings, at their highest since 2013, suggest the retail community is on side but more generally the market is pricing below ING's more bullish inflation stance.

We expect prices to break out to the upside this quarter

Starting this Friday we expect the US labour reports to begin showing a shift towards lower jobs growth and higher wage growth. Surveys are increasingly pointing to labour shortages and the NFIB small business survey shows the proportion of companies planning to raise compensation is now the highest since the early 2000's. Indeed our economist James Knightley reported growing concern from US corporates about retaining staff in his recent [US/Lat Am trip](#). With wage growth forecast to test 3% later this year along with additional factors (cell phone data plan charges, medical care costs, dollar weakness and rising commodity prices) inflation should hit similar levels.

On the flip side, with rising inflation comes the likelihood of greater Fed interest rate hikes and our

economists are sticking to 4 hikes even after the latest dovish tone from Powell. The speech given at the end of March shifted consensus to only 3 but even so, this gave way to the briefest of gold rallies. All things equal another reversal of expectations might only have minimal effect. Still, inflation alone might not be sufficient to drive a break out should real returns also rise (ING rate strategists see 10-year yields above 3% by H2 2018). For full confidence, we need to also weigh in prospective drivers for safe-haven demand and a rotation out of dollar-denominated assets.

In Gold we Trust

Rising trade tensions, twin US deficits and any further stock market corrections could be major incentives to drive safe-haven flows in the coming months, tempting Gold to break into a higher range.

Trump's trade tariff's on steel and aluminium have now escalated to \$50-60Bn of US-China trade with China seeking retaliations on about the same. Our base expectations fall far short of a full-blown trade war that would significantly derail global growth but nonetheless, we still see US policy uncertainty and the administration's own desire for a weaker USD as presenting an opportunity cost for investors holding USD reserves. It is in this light that we think the diversification and rotation away from US assets will ultimately discount the appeal of US yields, weigh on the greenback, and boost gold's dollar-denominated price.

There could be major incentives to drive safe-haven flows in coming months

Although some recent bond relief has come from the domestic asset rotation out of sliding US equity markets into treasuries, it will ultimately be the appetite of international buyers of US debt that will be tested should trade tensions escalate. Any increases in borrowing costs will need to be viewed in the context of burgeoning twin deficits that further motivate a weaker USD. All in, ING FX strategists stick to 1.30 vs the EUR by year end, 1.35 by the end of 2019 and see the recent narrowing DXY range as a bearish consolidation before a next move lower this spring. Above all, we highlight the political tensions going into a mid-term election year (Q3). Should the dollar indeed resume its bearish trajectory then higher US yields and rate hikes will lesser detract from gold's appeal. The continually elevated VIX reading suggests more equity outflows could be on the cards sooner rather than later.

Of course, the test will also be whether Gold can benefit from meaningful safe-haven flows that in Q1 seemed to have preferred alternative currency pairs eg. JPY. On the trade war assumption, Gold holds up better than currency pairs since it is global and not just regional growth at stake. It's also necessary to point out the good fundamental drivers for gold this year that could kick-start returns. Jewellery indicators are on the up, especially in China (spending up 3% YoY in Feb, growing Hong Kong visitors, and Swiss watch exports into double-digit growth). Consultancy Metals Focus thinks jewellery demand will be at a three year high in 2018 which accompanied by a 4% surge in physical investment is met by just a 0.1% increase in mine supply. The fund flows will be what matters most for Gold to finally break out this quarter but initial price support from the fundamentals should tempt the funds to return to holding gold as further asset rotations take place.

High VIX anticipates further equity corrections (%)



Source: CBOE, ING Research