Sucden Financial

FX Monthly Report– Gold

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Research Desk
research@sucfin.com

Press Enquiries
press@sucfin.com

Authors:

Daria Efanova
Head of Research

Daniel Henson
Head of FX

Nimit Khamar
FX Desk Broker

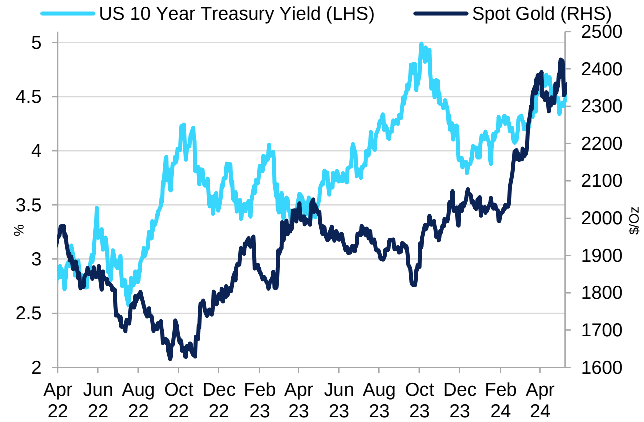
Chris Husillos
FX Desk Broker

Gold Focus

After months of winter range-bound, lacklustre markets, the start of spring marked a rally in the commodity space, with gold taking the lead. What's the outlook for the precious metal, which has surged by more than 15% since the beginning of March?

US 10-year Treasury Yields vs Spot Gold

The correlation between gold and the 10-year Treasury yield has softened recently.

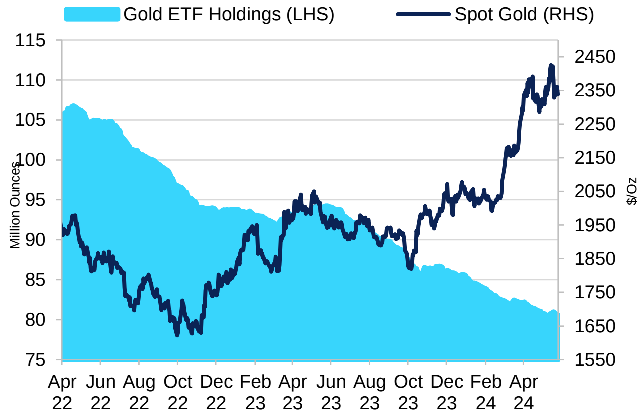


Source: Bloomberg

Consecutive record highs have unsurprisingly raised questions about the dynamics behind gold's incredible performance. While the growing expectation of the first Fed interest rate cuts has undoubtedly favoured gold, boosting its appeal based on the prospect of decreasing interest rates and Treasury yields, monetary policy wasn't the main driver. We believe that the spring rally was driven by a combination of strong physical demand in Asia, amid a lack of alternatives for safe-haven investment, and speculative action fuelled by increased geopolitical risks. With global ETF holdings at their lowest level since August 2019, the recent surge in gold prices was clearly driven by buyers outside the ETF market: central banks and individual investors purchasing physical gold. Following the strategic use of its currency by the US to impose sanctions against Russia, emerging market central banks were influenced to increase their gold reserves as a more secure asset amid geopolitical and economic uncertainties. According to the World Gold Council, this trend has continued into the first months of 2024, with the Central Bank of Turkey and the People's Bank of China taking the lead. Meanwhile, gold has also become an attractive investment for individual consumers seeking a safe way to store their money in an increasingly uncertain environment. This has been especially true in China, where a property crisis and weak stock market performance have heightened gold's attractiveness relative to other assets. Recent data from the National Bureau of Statistics (NBS) points to a continuing slump in China's house prices, with April marking the tenth straight month of declines, while the CSI 300 remains almost 40% below its peak in 2021.

Gold Spot vs Total Known ETF Holdings

Global gold ETF holdings remain at multi-year lows.

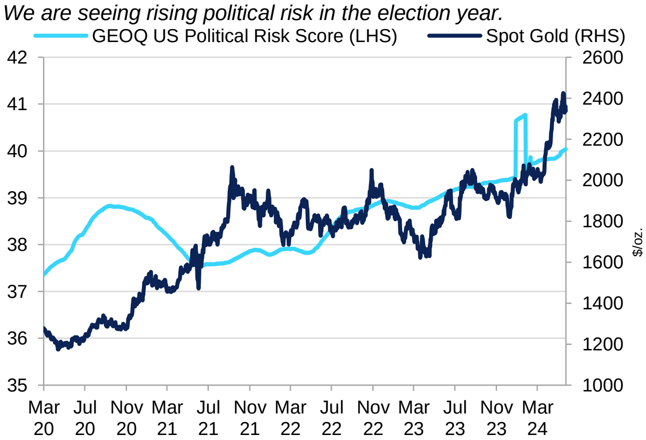


Source: Bloomberg, Sucden Financial

While the Chinese real estate crisis, US elections, and uncertainties stemming from ongoing conflicts in Ukraine and the Middle East are likely to maintain elevated volatility, we anticipate that the direction of precious metal prices will once again be heavily influenced by monetary policy guidance moving forward. Recent economic data from the world's largest economy show continued strength despite the prolonged period of high-interest rates. Although final US GDP growth in Q1 2024 came in lower than expected at 1.6% QoQ, this was largely due to a surge in imports to meet strong domestic demand. May's PMI data showed the highest business activity since April 2022, led by the service sector. Rising input costs and output prices indicate businesses are passing higher costs to consumers, complicating efforts to reduce inflation to 2%. Persistently sticky headline Consumer Price Index (CPI) prints this year have complicated the outlook for the Fed doves, despite gradual easing in the core index. Recent reports show significant declines in food and energy prices, but services, particularly shelter, continue to see strong price increases. Positive economic data, coupled with persistent inflation, continue to advance investors' expectations of Federal Reserve interest rate cuts, keeping Treasury yields high and exerting upward pressure on the dollar. This dynamic creates headwinds for gold.

GEOQ US Political Risk vs Spot Gold Price

We are seeing rising political risk in the election year.



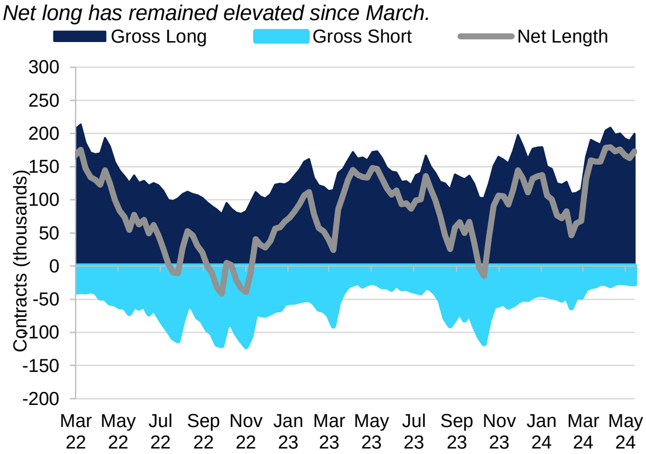
Source: Bloomberg

At the beginning of April, forward swaps were indicating a more than 60% likelihood of the first Federal Reserve interest rate cut in June; however, recent strong PMI figures have reduced that probability to

0%. With the economy remaining robust, the Federal Reserve can afford to delay easing monetary policy until it is certain that price stability has been achieved. In his latest statement, Powell highlighted that achieving confidence in sustained price stability might take longer than anticipated. Currently, market expectations are set for the first interest rate cut in Q4 2024. We believe that if this rate cut does not occur in September, the Federal Reserve will likely postpone the initiation of monetary easing until December, given that an intervention during the election month is improbable. In the meantime, we expect Treasury yields to remain elevated, with 10-year US Treasury yield around the 4.4% level, capping gold momentum. Monitoring macroeconomic data releases will be crucial in the coming months, as any signs of a weakening economy or softening inflation could create a short-term upside for gold. However, the scale of this upside is likely to be marginal, and corrections are to be expected. The $2,350/oz level serves as robust support and breaking well above the $2,400/oz level will require another bullish catalyst, such as the confirmation of an interest rate cut. If this doesn't occur, we expect gold to struggle to rise above this level.

Gold Managed Money COT

Net long has remained elevated since March.



Source: Bloomberg

Overall, the outlook for gold in the coming months appears cautiously optimistic, influenced heavily by global economic indicators and central bank policies. The precious metal's ability to break significantly above $2,400/oz will hinge on further economic uncertainty or explicit monetary easing by the Federal Reserve. We will closely monitor upcoming US economic data and Fed communications, as these will be critical in determining the timing and extent of any interest rate cuts. If the expected rate cuts are delayed or minimized, gold may face challenges in reaching new record highs. We believe that the upside for gold in the next two months will be marginal, and the metal is likely to follow a zig-zag pattern as it edges higher.

Desk Comments

GBP

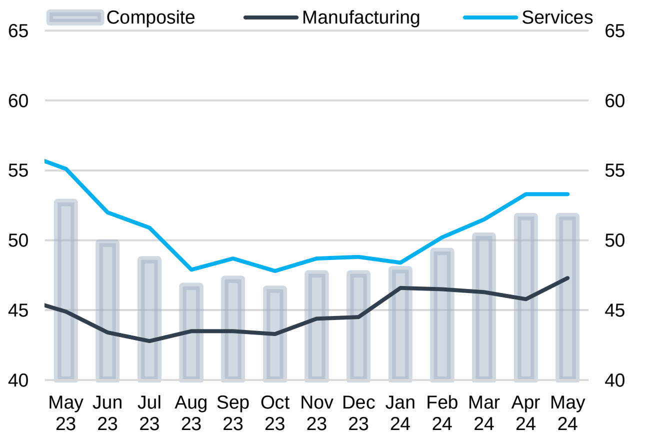
The main driver in May came from the inflation print a few weeks ago. The higher-than-expected print has seen August pricing come off by 13bp and now shows less than 2 cuts priced in this year. As a result, GBP momentum has gathered pace. In addition, wages remain robust, and growth is holding up, pushing EURGBP to the lower level of the recent range. We still look to sell on rallies as GBP should continue to outperform. Vols continue to realise lower. Current implied vols show no additional risk priced in for the UK election due in early July. After 14 years of conservative rule, polls are indicating a labour majority. We expect the market impact to be limited and doubt a change in government will deliver different growth outcomes. Early indications offer signs of continuity rather than major change. Moreover, the ghost of the mini budget in 2022 still looms and any drastic change to fiscal policy is unlikely to materialise. In our view a labour led government will have a more united stance toward the EU and will see a softer implementation of post-Brexit regulation boosting growth and easing inflation through opening of supply chains resulting in the potential for further GBP strength in the near term.

EUR

EUR CPI came in higher than expected in May. Confirms the model we have seen over the past months of a strong underlying pressure on inflation from service prices. Despite this the ECB is likely to cut this month; 25bp priced in. The key will be on the narrative. Price action is likely to remain muted, implied vols have drifted lower again, realising below 4%. The current yearly range in EURUSD is the lowest on record and with the main driver being rate expectations, which remain on a similar path, we don't expect the rate to diverge too much. Due to the sticky inflation and strong labour data the ECB will await further data releases before embarking on a series of rate cuts. An increase in vol is more likely to come from positioning ahead of US elections or escalation in geopolitical tensions.

Eurozone PMIs Performance

Manufacturing performance improved in May.



Source: Markit

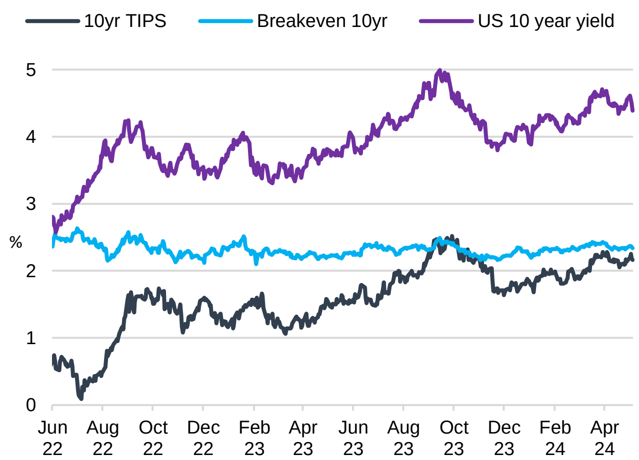
If the cut this week goes ahead as expected it will be the first time in two decades the ECB have managed to start monetary easing without being forced by a global financial emergency or European debt crisis. The risk of recession ended with an unexpected growth surge and there is no sign of the fragmentation fears that surfaced when the ECB initiated the hiking cycle. Therefore, the risks are likely to remain on EUR strength in the near term unless more hawkish members change their stance. We prefer being long against CHF.

USD

USD The USD Index pulled back last month due to a combination of signs indicating a softening US economy and better than expected economic activity elsewhere. As mentioned in a previous report, the higher-for-longer scenario appears to be priced in, so any data suggesting a weakening US economy is likely to weigh on the USD. Recent economic data shows subdued new order growth, increasing inventory levels, rising unemployment, and the lowest non-farm job creation number in 18 months—all pointing to a softening trend. Additionally, a decline in new business formations and a 16% rise in bankruptcy filings during the 12-month period ending March 31, 2024, indicate further softening, particularly in the labour market as companies feel the impact of high interest rates.

10yr TIPS vs 10yr Breakeven vs 10yr Yield

US 10-year yield remains elevated.



Source: Federal Reserve

Despite this softening, the current overall strength of the US economy allows the Federal Reserve (FED) time to wait for more evidence of inflation being under control and economy cooling. We believe this evidence will emerge by September, as official numbers often lag behind reality. Therefore, we anticipate the first rate cut will likely occur in September. It would be challenging for the FED to initiate any changes in the November meeting, being similar time to the US elections. The desk still expects to see a 75-basis point cut in 2024, which could happen in one go if the FED doesn't take the opportunity to cut before the elections. The current rate environment is geared towards a high/ worsening inflation scenario, which we are no longer experiencing.

Over the next few months, we expect the USD to remain rangebound with a slight downside bias. We anticipate it will be weaker compared to other G7 currencies while remaining firmer against emerging market (EM) currencies.

Technical Analysis

GBPUSD

GBPUSD pushed higher testing the white down trendline. We expect GBPUSD to consolidate between the wedge formed by white downtrend line and green trendline. On the upside, a close above white trend line and the 200-week moving average likely to lead to retest of 2023 highs at 1.3142, with a break above could see the cross target 2022 highs @ 1.3749. On the downside, a close below green trendline could lead to a move lower with support coming @ 1.2037 and then 1.18; support beyond there coming at 1.1420 (61.8% fib).

EURUSD

EURUSD traded higher but remains in the range, we expect EURUSD to continue trading rangebound with a break out of the wedge indicating future direction. On the upside, a break above white trend line could see market test Red trendline/200day Ma, with a close above leading to market testing highs from July @ 1.1276, with resistance beyond there coming at 1.1495/1.1500. On the downside a break below blue trend line will lead a test 1.05/1.0448 (lows from Sep), with a close below to lead to further declines to 1.02 (61.8% Fib)

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United Kingdom
Sucden Financial Limited
Plantation Place South
60 Great Tower Street
London
EC3R 5AZ

Tel: +44 (0)20 3207 5000
Email: info@sucfin.com

USA
Sucden Futures Inc.
156 West 56th Street
12th Floor
New York, NY 10019
United States

Tel: +1 212 859 0296
Email: ny@sucfin.com

Hong Kong
Sucden Financial (HK) Limited
Unit 1001, 10/F
Li Po Chun Chambers
189 Des Voeux Road Central
Hong Kong

Tel: +852 3665 6000
Email: hk@sucfin.com

sucdenfinancial.com