



Gold: More than meets the eye

Richard Tan, CFA – Toronto

In a conversation with RBC Capital Markets, LLC Commodity Strategist Christopher Louney, we look at aspects driving the gold rally and explain how world events and policy shifts could impact its prospects. Louney also gives his take on why gold investors should pay close attention to inflation, but not for the reason they may be thinking.

Richard Tan: Gold prices have rallied significantly, leading to several new all-time highs this year. You've argued that strong central bank buying has been a key culprit. What percentage of global demand do these purchases account for, and is the pace sustainable in your view?

Christopher Louney: Gold prices have touched new highs year to date, largely on the back of strong central bank demand, high physical demand, strong interest in China, and geopolitical concerns. In 2022 and 2023, official sector demand for gold, which includes national central banks and similar institutions, surpassed 1000 tonnes, with China and Poland adding the most last year. This was nearly a quarter of global demand each year, and more than double the prior five-year average. Strong demand from central banks is sustainable, in our view. We forecast above-average demand this year and next. Year-to-date demand has been at least that strong, as central banks continue their efforts to diversify their holdings and, in some cases, de-dollarize—trends which currently show no sign of abating.

How does geopolitical risk factor into gold prices?

Geopolitics factor into gold as do most crises generally, largely stemming from gold's role as a perceived safe

Historical price of gold

USD/ounce



Source - Bloomberg

haven. This reputation is a key part of its identity and perceived value among investors—up there with its history, low correlations with other financial assets, diversification benefits, liquidity in times of crisis, etc. In fact, many of these ideas are intertwined. In a world where we are seemingly just moving from one crisis to the next, this makes gold interesting to many. While we

For perspectives on the week from our regional analysts, please see [pages 4–5](#).

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think gold’s reputation and attractions are deserved, the gold picture is more nuanced than many people believe. Gold’s performance is consistent in the short term whether in reaction to a geopolitical or an economic crisis but differs in the long term. In the very short term, it tends to perform regardless of the type of crisis, but as near out as one month and beyond, performance can become more mixed. For gold to hold on to geopolitical gains, there usually needs to be some sort of economic fallout. With wars ongoing in the Middle East and in Europe, there is a near-term geopolitical bid that the market is pricing in. That said, markets appear to be looking for a retracement in the Middle East and European geopolitical risks, in our view, understandably eager for an offramp, making these gains vulnerable over the long term. **This risk impact on the gold price can endure while the crisis rages on, but to remain beyond that would require other catalysts.**

Many consumers and businesses continue to battle the effects of inflation and higher interest rates. What’s your assessment of demand from the real economy?








Gold has a reputation as a hedge against inflation and a store of value. While there are alternatives explicitly designed to hedge against inflation and there are even

other commodities which themselves are components of headline inflation, over the very long term, gold can store value. However, gold’s ability to hedge all types of inflation on a consistent basis is mixed. We think of gold as a good hedge against surprise, extremely high, and monetary-driven inflation. Thus, when inflationary fears are running high, physical gold tends to get quite a bit of attention, something we have seen play out recently. Today, there does seem to be strong demand from gold consumers, initially led by China but now globally, to hedge against inflation (and for a host of other reasons). We think inflation data is perhaps more telling in how it impacts the Fed’s decision making around monetary policy. So, in our eyes, gold investors should watch inflation more for what it means for interest rates, rather than just for inflation itself.

How do you think supply growth will unfold in the coming years?

Total gold production can still manage some gains both in 2024 and in 2025, in our view, but it is important to remember that annual gold production simply adds to above-ground stocks each year. In fact, the best estimates point to more than 200,000 tonnes of gold having been

The near-term DRIVERS framework

D	R	I	V	E	R	S
Dollar	Rates	Inflation	Volatility & equities	ETFs & investor flows	Reserves	Supply & demand
The U.S. dollar strengthened since the start of this year on average. This should be gold negative but that has yet to be realized this year.	Rates have also risen on average since the start of the year, which should be gold negative, although gold has continued to realize new highs so far.	We remain of the view that gold is not the inflation hedge many think. But persistent inflation is impacting the Fed. This should be mildly negative for gold.	Volatility doesn’t appear to be a significant driver, but pricing patterns versus equities indicate gold may be trading as a risk asset, in contrast to physical indicators.	Flows remain extremely poor with 2024 seeing additional outflows. We think this should be more of a drag on gold unless it turns for the better.	Headlines about strong central bank interest are one of the key drivers judging by recent headlines and price outcomes. This is real, but there are other drivers, too.	Supply seems to be a non-issue in the current market, but physical demand looks like a strong driver based on current prices and relevant headlines.
 Mild	 Mild	 Mild	 Mild	 Strong	 Strong	 Strong

**The DRIVERS framework
(Dollar; Rates; Inflation; Volatility & equities; ETFs & investor flows; Reserves; Supply & demand)
... and beyond**

Based on the mix of drivers, their strength, and what we view as the most impactful drivers of the moment, we believe pressure on gold should be mildly negative in the short term (in line with our high-scenario price outlook and other scenarios). We think gold price strength has gotten ahead of itself on the back of physical interest and central bank demand, but the repricing of rate cut narrative and macro factors point to lower prices, in our view. We may be wrong here, but we think if we are, it is for the right reasons. If investors get behind this move with consistent inflows, our minds could be changed.

Arrows indicate the direction of near-term pressure; *minimal, mild, medium, or strong* indicates the strength of the effect.

DRIVERS categories can change over time as gold is fickle and factors shift in importance and relevance from time to time.

mined throughout history, almost all of which is believed to still be around in one form or another. Thus, while gold production can continue to grow before peak supply becomes a headline, it is still simply added to above-ground stocks. On an annual basis, perhaps more interesting this year will be scrap supplies, as holders sell their existing gold jewelry and other fabricated pieces given high prices. We expect sales from this source to be elevated this year in response to new high ground for the gold price.

What is the biggest source of vulnerability for gold, in your view?

The available evidence points to continued strong interest from central banks and from China. There are also signs of growing physical interest in the U.S. However, these are not usually the most price-predictive parts of our analysis, nor is data the most timely. It is important to stress here that these are relevant factors for gold, but rarely in recent times have they been the overriding drivers of price or the most predictive parts of valuation models on a sustained basis. Gold models often rely much more on macro drivers such as interest rates (which remain high, elevating the opportunity cost of holding gold), the dollar (which remains strong) and other factors. **By most of those measures, gold is actually quite overvalued. But even when using a blended price model like ours for example, gold still looks overvalued versus our high-estimate scenario.** Perhaps this is a signal to readjust our expectations. Or perhaps the potential downward pressure indicated by macro drivers is just not important right now. We certainly may be wrong, and central bank and physical demand really can push gold prices even higher before an eventual interest rate cut arrives, but given the lack of investor follow-through (exchange-traded funds [ETF] flows everywhere but Asia remain squarely negative), we still think there are vulnerabilities yet to be realized in gold.

Gold prices have pushed past your Q2 2024 high scenario forecast of US\$2,282 per ounce. What is required in your view for gold to retrace back to your Q2 2024 middle scenario of US\$2,068 per ounce? What is your outlook for the back half of 2024 and into 2025?

We still think that gold prices have gotten ahead of themselves, but there are important factors driving gold prices so high. While we point to our high scenario as the most likely, as current prices have outpaced even that, we question whether central bank demand headlines and strong physical demand alone can overwhelm macro factors permanently, which as noted above, point to lower prices. Additionally, we still see a lack of investor follow-through on this move almost everywhere except for Asia (ETF outflows continue). There are plenty of reasons why gold prices have been strong, but we urge market participants to not ignore the fact that gold prices are currently dislocated from most pure macro valuations, even if returning to our middle scenario prices is unlikely this year. In 2025, our high-scenario forecast is US\$2,394 per ounce, which provides context to just how far ahead of itself gold may have gotten, in our view.

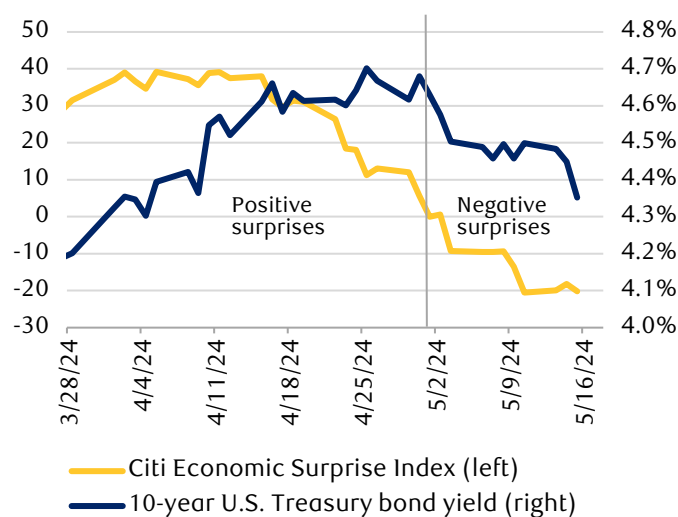
UNITED STATES

Alan Robinson – Seattle

- **U.S. stocks rallied during the week with the S&P 500 Index setting a new record high**, driven by economic data that investors perceived as soft enough to open the door to more interest rate cuts, but not so weak as to trigger fears of a hard landing.
- Monthly inflation data provided the highlight of the data releases. **The headline Producer Price Index (PPI) for April was up 0.5% m/m**, greater than the consensus forecast for a 0.3% rise. **But this was offset by downward revisions to prior months, with the net result the annual rate of final demand PPI inflation only edged up to 2.2%, from 2.1% in March.**
- The **April Consumer Price Index (CPI) was also benign**, with annualized core CPI (excluding food and energy prices) **down 0.2 percentage points to 3.5%, the lowest in three years.** Excluding the shelter category for which data tends to lag real-time prices, core CPI declined to 2.2% y/y.
- **Other significant economic data included retail sales that came in flat, elevated unemployment claims, and weak industrial production, housing data, and sentiment surveys.** Investors interpreted all of this as positive for stocks as the data implied a greater likelihood of interest rate cuts from the Fed. The bond market seemed to agree, with yields moving lower in tandem with negative economic surprises (see chart).

Bad news is good news for bonds

Quarter-to-date bond yields show a strong correlation with negative economic data



The Economic Surprise Index measures the difference between actual data and consensus forecasts.

Source - RBC Wealth Management, FactSet; daily data through 5/15/24

- **However, this wave of “risk on” sentiment in the face of a weakening economy may have pushed some asset prices a little too far, in our view.** One of the more alarming warning signs we saw was the rise in prices of “meme stocks” during the week. These are stocks that tend to move in reaction to social media hype more than fundamental drivers, and they can sometimes signal speculative fund flows. Two stocks in particular, GameStop (GME) and AMC Entertainment (AMC), posted intra-week gains of well over 200% at one stage before settling back with more modest gains.

CANADA

Claudia Humbert, CFA – Toronto

- **Canadian jobs data for April was somewhat weaker than it appeared on the surface.** The economy added 90,000 jobs, which exceeded expectations but was insufficient to keep up with population growth. The labour force grew by 112,000 in April, primarily driven by immigration. Other indicators signaled a cooling labour market, consistent with inflation trending towards the Bank of Canada’s (BoC) 2% target. The unemployment rate held steady at 6.1%, a percentage point higher than a year earlier, a level which has helped to moderate wage growth. Average hourly earnings rose by 4.7% y/y, down from 5.1% in March. Additionally, a series of weaker-than-expected gross domestic product reports has created a favourable environment for the BoC to consider rate cuts. Investors are now keenly awaiting the Consumer Price Index report, due on May 21, for further insights into potential rate policy shifts. Market sentiment currently suggests a nearly 50% chance of a rate cut at the BoC’s June meeting, with a rate cut fully priced in for July.
- **The Canadian Real Estate Association reported a 1.7% m/m decline in home sales for April**, with Vancouver being a notable outlier due to a slight increase in seasonally adjusted sales. Persistent challenges such as poor affordability and high interest rates continue to deter potential buyers. Meanwhile, the number of newly listed homes increased by 2.8% m/m, as some sellers aim to capitalize on the busier spring market or worry about their ability to afford their mortgages if interest rates stay high. The imbalance between slower sales and more new listings led to a 6.5% m/m rise in total market inventory, the highest level since before the pandemic and the second-highest month-over-month increase on record. The MLS Home Price Index remained flat for the third consecutive month but showed a 0.9% y/y decline. RBC Economics anticipates that a sustained recovery in home sales will likely begin in the latter half of 2024, coinciding with expected interest rate reductions from the BoC.

EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

■ **Higher interest rates seem to be finally cooling the UK labour market.** The unemployment rate edged up to 4.3% in the three months to the end of March on a year-over-year basis, though this should be taken with a grain of salt given the marked decrease in the survey response rate since the pandemic. Consequently, private sector pay growth has inched down to 5.9% in the three months to the end of March from 6% in the same period a year ago.

■ **Overall, we think this data still points to the Bank of England embarking on its rate cutting cycle in August,** though it will be closely watching the April services Consumer Price Index report slated for release on May 22.

■ Having lagged other major markets earlier in the year, **the UK's FTSE 100 Index has been one of the best-performing equity markets since the start of March, with a total return of around 12%** in both GBP and USD terms, marking new all-time highs in the process. Over two-thirds of the recent rally stems from the outperformance of: Banks, supported by a brightening of the UK's macro outlook; Energy and Materials being buoyed by higher commodity prices; and AstraZeneca (8.5% weighting of the FTSE 100) within the Pharmaceuticals sector.

■ **UK equities remain inexpensive in both absolute and relative terms,** even after adjusting for sector weightings. While that has been the case for some time, we think **two notable dynamics are at play which could potentially support a re-rating of the UK equity market.** Firstly, there is an increasing number of companies undertaking share buybacks, indicating management teams view their own share prices as undervalued. Secondly, there has been a significant pickup in takeover interest in UK-listed companies, particularly from overseas competitors seeking to acquire smaller, and lower-valued, UK peers.

■ **The biggest UK takeover target so far in 2024, miner Anglo American, rebuffed BHP's second takeover approach,** which valued the former at £34 billion, before outlining its standalone plans to accelerate shareholder "value delivery." BHP has until May 22 to either announce a firm intention to make an offer for Anglo American or that it does not intend to make an offer.

ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

■ **The Asia Pacific equity market traded higher during the week,** with the MSCI All Country Asia ex Japan Index posting a fresh two-year high despite renewed trade tension between the U.S. and China. On Tuesday, the Biden administration unveiled steep tariff increases on an array

of Chinese imports including electric vehicle batteries, computer chips, and medical products. China vowed to take its own action, without giving specifics.

■ **China is studying a proposal to have local governments buy up unsold homes,** according to a Bloomberg report. Local governments will be asked to help purchase unsold homes from distressed developers at steep discounts using loans provided by state banks, and many of the properties will then be converted into affordable housing. The State Council, China's chief administrative authority, is seeking feedback from several provinces and government entities on the preliminary plan, and officials are still debating details of the plan and its feasibility. China's home sales fell approximately 47% y/y in the first four months of the year and unsold housing inventory is hovering at an eight-year high, according to the China Index Academy, a private real estate research firm. On April 30, the Communist Party of China vowed to explore new approaches to ease the real estate crisis and investors have been waiting for more details. This is not the first time Beijing is experimenting with clearing home inventory via state funding. We think if the current proposal is approved, it will likely be of a much larger scale and some industry observers think it could cost between 1–2 trillion yuan.

■ **Tencent Holdings Ltd. (700 HK) and Alibaba Group Holding Ltd. (9988 HK) both reported Q1 results this week.** Tencent's net income rose 57% y/y and net margins expanded to 32%, both ahead of consensus expectations. On the other hand, Alibaba's net income fell 11% y/y, missing expectations, weighed down by Taobao/Tmall, International Digital Commerce, Cainiao, and others.

China investor sentiment boosted by potential new government measures

CSI 300 Real Estate Index



Source - RBC Wealth Management, Bloomberg; daily price data since 5/15/23

MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	5,308.15	5.4%	11.3%	28.3%	31.9%
Dow Industrials (DJIA)	39,908.00	5.5%	5.9%	19.7%	24.0%
Nasdaq	16,742.39	6.9%	11.5%	35.4%	41.8%
Russell 2000	2,109.46	6.9%	4.1%	19.8%	17.7%
S&P/TSX Comp	22,284.76	2.6%	6.3%	8.5%	10.9%
FTSE All-Share	4,596.71	3.8%	8.6%	8.5%	12.1%
STOXX Europe 600	524.71	3.9%	9.5%	12.4%	21.0%
EURO STOXX 50	5,100.90	3.7%	12.8%	18.2%	37.7%
Hang Seng	19,073.71	7.4%	11.9%	-4.5%	-4.1%
Shanghai Comp	3,119.90	0.5%	4.9%	-5.8%	1.2%
Nikkei 225	38,385.73	-0.1%	14.7%	29.6%	45.2%
India Sensex	72,987.03	-2.0%	1.0%	17.1%	38.2%
Singapore Straits Times	3,289.42	-0.1%	1.5%	2.3%	3.1%
Brazil Ibovespa	128,027.59	1.7%	-4.6%	17.4%	19.7%
Mexican Bolsa IPC	57,465.18	1.3%	0.1%	4.0%	15.9%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	4.340%	-34.0	46.1	83.8	142.2
Canada 10-Yr	3.562%	-25.4	45.2	61.4	60.2
UK 10-Yr	4.066%	-28.1	52.9	24.9	232.2
Germany 10-Yr	2.422%	-16.2	39.8	11.3	147.4
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	5.06%	1.7%	-1.6%	0.8%	0.0%
U.S. Investment-Grade Corp	5.51%	1.7%	-1.3%	3.9%	4.1%
U.S. High-Yield Corp	7.92%	1.0%	1.5%	10.6%	14.2%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	2,387.86	4.4%	15.7%	18.4%	31.8%
Silver (spot \$/oz)	29.70	12.9%	24.8%	23.3%	40.6%
Copper (\$/metric ton)	10,008.46	1.2%	18.2%	21.8%	9.0%
Oil (WTI spot/bbl)	78.02	-4.8%	8.9%	9.7%	-29.4%
Oil (Brent spot/bbl)	82.95	-5.6%	7.7%	10.3%	-25.6%
Natural Gas (\$/mmBtu)	2.41	20.9%	-4.3%	1.3%	-68.6%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	104.3130	-1.8%	2.9%	1.8%	-0.2%
CAD/USD	0.7350	1.3%	-2.7%	-1.0%	-5.1%
USD/CAD	1.3605	-1.3%	2.7%	1.0%	5.2%
EUR/USD	1.0883	2.0%	-1.4%	0.1%	4.5%
GBP/USD	1.2685	1.5%	-0.4%	1.2%	3.4%
AUD/USD	0.6693	3.4%	-1.7%	-0.1%	-3.6%
USD/JPY	154.8900	-1.8%	9.8%	13.8%	19.9%
EUR/JPY	168.5800	0.2%	8.3%	13.9%	25.3%
EUR/GBP	0.8580	0.5%	-1.0%	-1.1%	1.0%
EUR/CHF	0.9820	0.1%	5.7%	0.8%	-5.9%
USD/SGD	1.3453	-1.5%	1.9%	0.7%	-3.4%
USD/CNY	7.2190	-0.3%	1.7%	3.8%	6.3%
USD/MXN	16.6863	-2.6%	-1.7%	-4.3%	-17.0%
USD/BRL	5.1366	-1.1%	5.8%	5.0%	1.5%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD -2.7% return means the Canadian dollar fell 2.7% vs. the U.S. dollar year to date. USD/JPY 154.89 means 1 U.S. dollar will buy 154.89 yen. USD/JPY 9.8% return means the U.S. dollar rose 9.8% vs. the yen year to date.

Source - Bloomberg; data as of 5/15/24

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As of March 31, 2024

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			Count	Percent
Buy [Outperform]	831	56.84	264	31.77
Hold [Sector Perform]	585	40.01	151	25.81
Sell [Underperform]	46	3.15	4	8.70

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