Gold

Quasi FX-Commodity Asset

5th October 2016

- Gold is perhaps one commodity that has always retained its safe haven appeal. Despite the yellow metal reaping absolutely no yield to its holder, gold has played its three-pronged roles: (1) as an effective store of value especially during inflation, (2) safe haven asset especially during economic crises and (3) currency hedge given that gold is generally viewed as a quasi FX-Commodity asset.
- With the yellow metal performing exceedingly well (its rally has even surpassed those of equities), one would then to attribute its rally to many instances of economic potholes since the start of the year. This includes the continued concerns over China's soft landing, weaker-than-expected US-centric labour prints (note that NFP had disappointed expectations for four months out of six months in the first half of this year) which then watered down expectations for US Fed rate hikes. The latest unexpected event which had crystal clear negative repercussion for Europe and arguably the global economy is Britain's vote out of the European Union (known as the Brexit). With one bad news after the other, it is of no surprise that market-watchers have fled into safe haven assets, namely gold, to brace against potential downside in growth.
- We recognise that gold isn't the sole safe haven asset in the market; there are other traditional safe haven assets which would include the US Greenback and the Japanese Yen. Still, given the weakening probability for the Fed to inject interest rate hikes and further potential easing by the Bank of Japan, these currencies may see further fall in value. Thus, with the limited headroom for both USD and JPY amid growth concerns, the only safe haven that holds its glitter is likely to be gold.
- Looking forward into 2016 (and 2017 to be precise), we note of further wildcards that market-watchers may increasingly be watchful about. This includes the US presidential elections in November, where any suspense over who takes office will most likely mould expectations over US economic & political health, and potentially lift gold on safe haven demands. Elsewhere, while the Brexit outcome had rather muted consequences at this juncture, given that Article 50 isn't being triggered just yet. With 2017 to be a likely year for it to be triggered, it presents to us another growth wildcard where past warnings by the IMF (Britain faces a recession in 2017), OECD (OECD economies to see 3.3% less GDP versus Britain staying in the EU by 2020) and World Bank (Britain's trade and foreign investment will be adversely affected, and a no-trade scenario with the EU will drag trade activities down by 55%) are possible outcomes then.
- Thus, the factors influencing gold are multi-faceted. One would point towards a potential rate hike in December 2016 (OCBC view is for the Fed to inject a 25bps rate hike in Dec) as a dominating factor to persuade gold prices lower.

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However, we opine that sustained risk-off sentiments into 2016 and potentially 2017 would continue to lift gold to our year-end call of $1,350/oz (if the Fed hikes rates at end-year) or $1,400/oz (if the Fed does not hike). So in a nut-shell, there is more upside risk to gold prices.