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BMO Global Commodities Research

Gold Here to Stay - You Can Take That to the (Central) Bank

Bottom Line:

Another year, another record nominal gold price. Yet still many investors shun the lustrous metal, questioning its role in a digital and decarbonising world. Evidently though, with annual gold demand (excluding OTC) reaching the highest level since 2011, estimated central bank demand surging to a 55-year high, and record Western retail investment, not all share this sentiment. In the near term much of the focus has turned to whether macro asset allocators will pivot back toward gold and help to sustain the recent rally in prices, amid a softening dollar and lower terminal rate expectations, or whether the fabled "soft landing" will ultimately see prices come under downward pressure.

Key Points

Central bank net additions jumped to the highest level in 55 years. Heightened geopolitical uncertainty, concerns over inflation, the lack of political risk, and its ability to act as an effective portfolio diversifier, were all reasons cited by central banks during the World Gold Council's (WGC) annual survey for continued buying. While we expect net additions to remain historically high this year (+599t), we do anticipate some moderation, particularly given notable estimated unreported purchases in H2 2022.

Traditional physical buying remains robust while macro asset allocators stay on the sidelines. Total investment demand rose 10% y/y to 1,107t in 2022, owing to a 2% increase in bar and coin demand (+1,217t) and with gold-ETF net outflows not as pronounced as the year prior (-110t vs. -189t in 2021). Into 2023, despite an expected uptick in Chinese buying after being hampered by lockdowns this year, we believe a more risk-on sentiment in H2 will keep bar and coin retail purchases broadly flat y/y.

Jewellery demand curbed by lockdowns and elevated prices. Jewellery fabrication fell 2% y/y to 2,190t, primarily due to a 15% drop in Chinese demand to 571t, while Indian purchases were somewhat tempered in the final months of the year amid rising prices. China's re-opening, coupled with a higher number of auspicious wedding days in India, should support jewellery demand this year. The risk being that another year of high inflation squeezes consumer finances and drags on buying.

Gold has hopped up into the Lunar New Year but needs macro support to stay here. BMO Economics highlights the probability of a soft landing coupled with quickly cooling inflation has risen to ~35% (vs. 25% previously), while the odds of a very bad outcome have receded. While recession risks cannot be ruled out, in our view a lot of the near-term positive catalysts for gold are close to running their course, namely dollar weakness and approaching the terminal rate, and although we do not see a sharp price retracement, we do expect a softening in H2.

Mine supply growth remains meagre despite recovery in Chinese production. Despite Chinese gold production increasing 13% y/y to 372t in 2022, with stronger output from the Shandong province which faced lengthy shutdowns in 2021 following mine accidents, global mine production only increased 1% y/y to 3,612t. Combined with relatively muted recycling (+1% y/y to 1,144t), which remains ~30% below the peak in 2012, we saw total gold supply rise 2% y/y to 4,755t.

For details of financial and operating metrics for all the gold companies under BMO equity coverage, please see our Gold Pages, published every week.

For disclosure statements, including the Analyst Certification, please refer to page(s) 6 to 8.

BMO Capital Markets

IN Depth

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Industry Research

Glossary

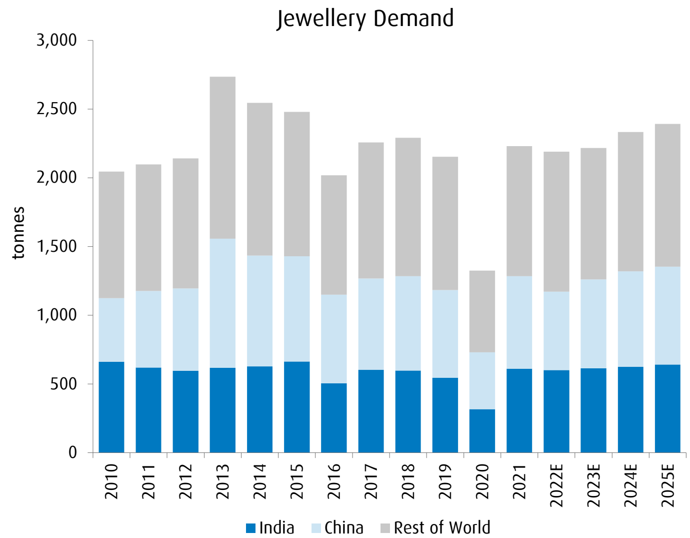
Gold Here to Stay - You Can Take That to the (Central) Bank

The release of the World Gold Council's annual Gold Demand Trends report for full year 2022 highlighted the appetite of traditional buyers remains robust despite the global economy witnessing one of the fastest rate hike cycles on record, and with sustained dollar strength through much of last year proving a sustained headwind. Total demand (excluding OTC) for the year surged 18% to 4,741t, reaching the highest level since 2011. Meanwhile, total supply rose 2% y/y to 4,755t, with mine supply up 1% y/y to 3,612t.

Jewellery demand curbed by lockdowns and elevated prices. Jewellery fabrication fell 2% y/y to 2,190t, as Chinese demand was hampered by repeated lockdowns (-15% y/y to 571t), while Indian purchases were somewhat tempered in the final months of the year amid rising prices. The alleviation of travel restrictions in China, and some additional household savings, should support a strong recovery in demand this year (+13% y/y to 645t).

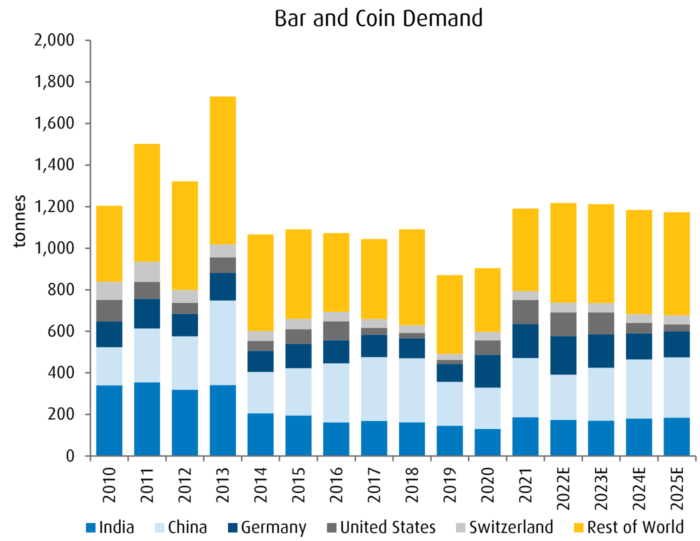
The outlook for India, the second largest gold jewellery buyer, is a little more mixed. Indian gold futures have recently rallied to a record high, tracking the recent rally in global prices and helped by a depreciation in the rupee. High prices are reportedly weighing on retail purchases, with the local market remaining at a >$40/oz discount over international US$ prices. That said, a higher number of auspicious wedding days in India this year should help offset any weakness owing to an elevated price environment. On balance we expect jewellery demand rising 1% y/y to 2,216t this year, despite the risk that another year of high inflation squeezes consumer finances and drags on buying.

Exhibit 1: Jewellery Demand Remains Robust Despite Weak China Purchases



Source: World Gold Council, BMO Capital Markets

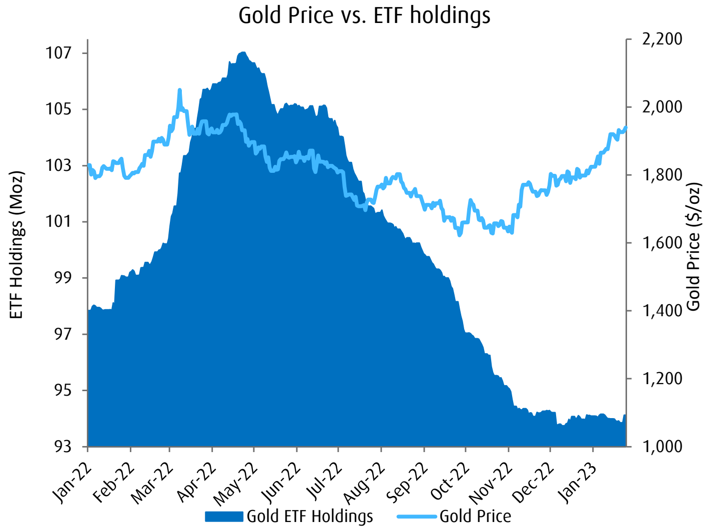
Exhibit 2: Retail Investors Still Exhibit Steadfast Belief of Gold's Relevance as an Inflationary Hedge



Source: World Gold Council, BMO Capital Markets

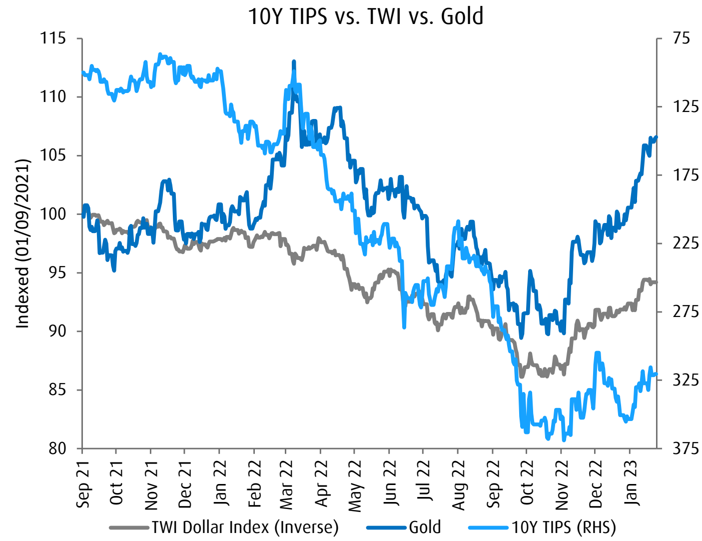
Gold has hopped up into the Lunar New Year but needs macro support to stay here. BMO Economics highlights the probability of a soft landing coupled with quickly cooling inflation has risen to ~35% (vs. 25% previously), while the odds of a very bad outcome have receded. While recession risks cannot be ruled out, in our view a lot of the near-term positive catalysts for gold are close to running their course, namely dollar weakness and approaching the terminal rate, and although we do not see a sharp price retracement, we do expect a softening in H2. In the World Gold Council's 2023 Outlook, it highlighted a soft landing scenario as likely leading to downward price pressure and although some of this narrative has seemingly softened already, if we do achieve the fabled "soft landing" gold's bull case may dissipate with it.

Exhibit 3: Macro Asset Allocators Show Little Sign of Pivoting Back Toward Gold...



Source: Bloomberg, BMO Capital Markets

Exhibit 4: ...Despite Sustained Headwinds From U.S. Dollar Strength and Rising Interest Rate Expectations Starting to Abate

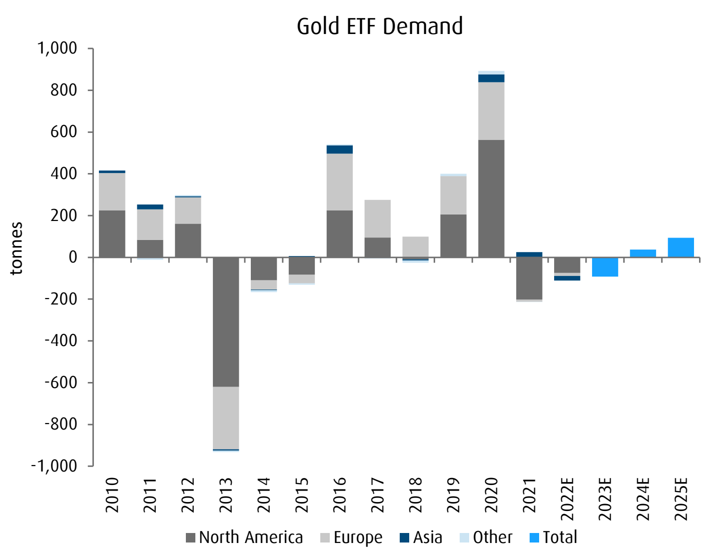


Source: Bloomberg, BMO Capital Markets

Traditional physical buying remains robust while macro asset allocators stay on the sidelines. Total investment demand rose 10% y/y to 1,107t in 2022, owing to a 2% increase in bar and coin demand (+1,217t) and with gold-ETF net outflows not as pronounced as the year prior (-110t vs. -189t in 2021). Indeed, European and U.S. retail investors combined bought record volumes of bar and coin in 2022, which helped to fuel the surge in physical premia. We expect much of the rationale underpinning historically high physical retail investment will fundamentally remain at least through the first half of the year, namely heightened geopolitical risk and broader macro uncertainty. Akin to jewellery demand, purchases are also likely to be aided by China's reopening and some drawdown of accumulated household savings. It may only be in the second half of the year, after the worst of macro headwinds have subsided and more risk on sentiment builds, that retail purchases soften.

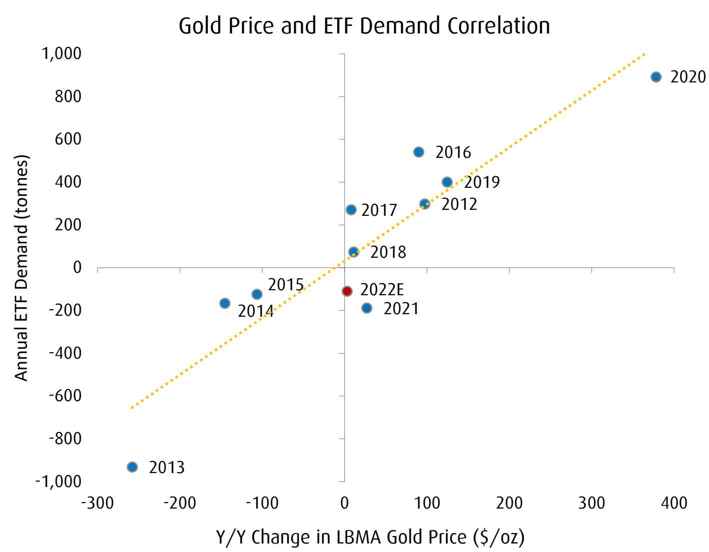
The thesis for a more marked pivot back to gold in the near term by macro asset allocators though is arguably harder to construct, given its notable absence thus far. The dollar softness seen since its September peak, combined with three relatively weak CPI prints and concurrent lowering of rate hike trajectories, has done little to date to spur sustained ETF inflows. Although we saw some inflows into North American funds in December, we expect ETF outflows to continue this year (-92t), albeit remaining modest and likely skewed to the second half of the year.

Exhibit 5: ETF Outflows Were Witnessed in All Regions Last Year...



Source: World Gold Council, BMO Capital Markets

Exhibit 6: ...Marking the Second Consecutive Year We Have Seen Annual ETF Outflows and an Increase in the Gold Price



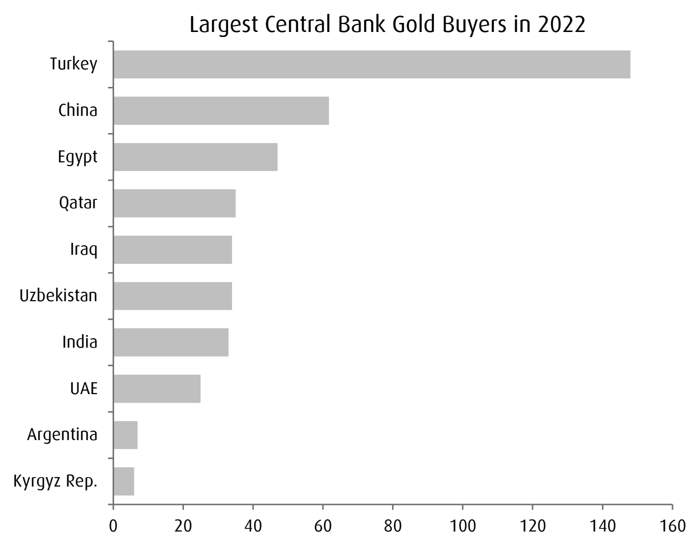
Source: World Gold Council, BMO Capital Markets

Central bank net additions jumped to the highest level in 55 years. Heightened geopolitical uncertainty, concerns over inflation, the lack of political risk, and its ability to act as an effective portfolio diversifier, were all reasons cited by central banks during the World Gold Council's (WGC) annual survey for continued buying. Notable reported purchasers were Turkey (+148t), China (+62t), Egypt (+47t), Qatar (+35t), Iraq (+34t), Uzbekistan (+34t), and India (+33t), while Kazakhstan reduced holdings by 51t to 352t and flagged further potential sales in 2023.

The actual level of central bank buying though is somewhat opaque, owing to the majority of purchases being "unreported". Part of these purchases can likely be accounted for by Russian additions, which are no longer reported, as it is believed they have increased purchases of domestically produced gold. While unconfirmed reports suggest that the People's Bank of China's holdings have increased by more than officially reported, we would question whether these two countries make up all the "unreported" additions. While we expect net additions to remain historically high this year (+599t), we do anticipate some moderation, owing in part to the assumption "unreported" buying cannot remain as significant this year.

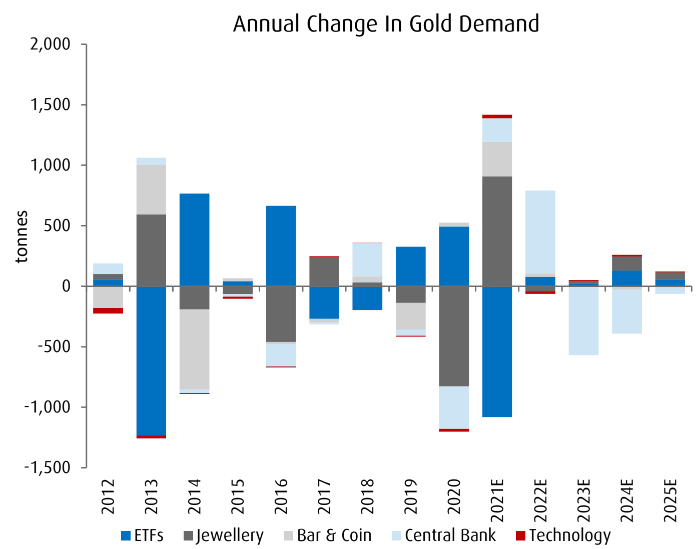
Technology demand struggled amid weakness in consumer electronics. Gold demand from the electronics sector fell 7% y/y to 252t, dragging down total technology demand 7% y/y to 309t in 2022, amid reported weakness in the Light Emitting Diode (LED) sector which has seen a material build in inventories, combined with a fall in utilisation rates at major chip manufacturers. Despite notable concerns over the inventory overhang, we expect technology demand to rise a modest 2% y/y to 315t this year.

Exhibit 7: The Highest Estimated Central Bank Net Additions in 55 Years…



Source: International Financial Statistics, WGC, BMO Capital Markets

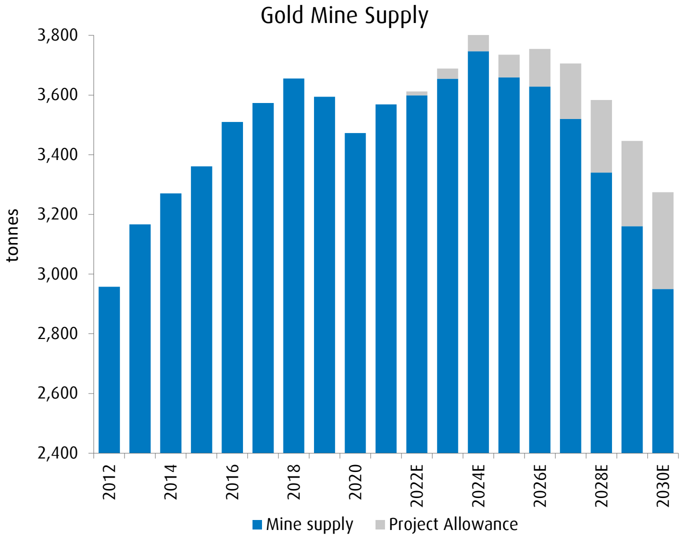
Exhibit 8: …Meant Macro Investment and Traditional Demand Did Not Follow Their Typical Trend of Offsetting Each Other in 2022



Source: World Gold Council, BMO Capital Markets

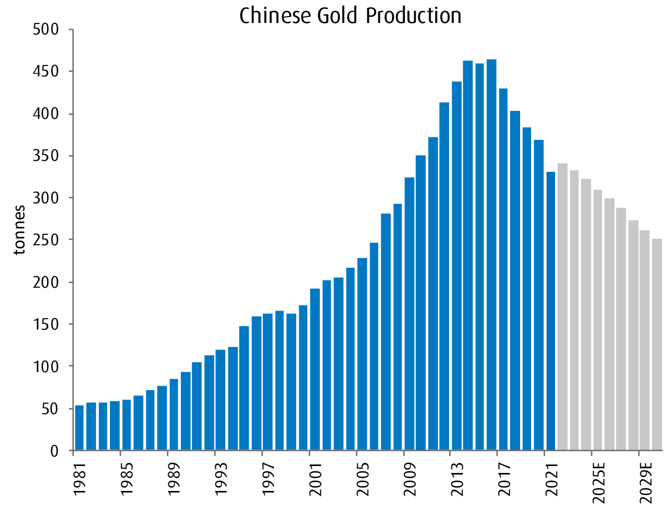
Mine supply growth remains meagre despite recovery in Chinese production. Despite Chinese gold production increasing 13% y/y to 372t in 2022, with stronger output from the Shandong province which faced lengthy shutdowns in 2021 following mine accidents, global mine production only increased 1% y/y to 3,612t. Combined with relatively muted recycling (+1% y/y to 1,144t), which remains ~30% below the peak in 2012, we saw total gold supply rise 2% y/y to 4,755t. Much like other commodities, we expect the alleviation of lockdown restrictions in China to help facilitate an increase in recycling this year (+5% y/y to 1,197t), which combined with higher mine supply (+2% y/y 3,689t) should see total gold supply reach 4,885t (+3% y/y).

Exhibit 9: Maintaining Even a Flat Production Outlook Poses a Significant Challenge



Source: Wood Mackenzie, World Gold Council, BMO Capital Markets

Exhibit 10: Chinese Mine Production Recovers Following Year Hampered by Safety Related Curtailments



Source: China Gold Association, BMO Capital Markets

Responsible sourcing mandates by consumers has the potential to reinvigorate gold equities. As detailed in our responsible sourcing report, we believe one of the lasting impacts of the supply chain segmentation seen over 2022 will be a focus on traceability of materials. In our opinion, this creates a unique opportunity for miners that can exemplify best practices when it comes to responsibly mined gold, and not just in terms of reducing carbon emissions. We believe that consumers will increasingly demand for it to be possible to trace their jewellery, or retail investment product, back to its origin with an assurance this meets an independently verified certification framework. To compare and contrast precious metals companies' reported ESG strategies please see this report.

Exhibit 11: BMO Gold S-D Balance

			2018	2019	2020	2021E	2022E	2023E	2024E	2025E	2026E	2027E
Supply												
	Mine supply	t	3,655	3,595	3,472	3,569	3,612	3,689	3,811	3,735	3,754	3,706
	Year-on-year chg	%	2%	-2%	-3%	3%	1%	2%	3%	-2%	1%	-1%
	Net producer hedging	t	-12	6	-39	-23	-2	0	15	15	0	0
	Recycled gold	t	1,132	1,276	1,293	1,136	1,144	1,197	1,180	1,180	1,180	1,180
	Total supply	t	4,775	4,876	4,726	4,682	4,755	4,885	5,006	4,930	4,934	4,886
	Year-on-year chg	%	2%	2%	-3%	-1%	2%	3%	2%	-2%	0%	-1%
Demand												
	Jewellery	t	2,290	2,152	1,324	2,231	2,190	2,216	2,333	2,391	2,446	2,481
	Technology	t	335	326	303	330	309	315	328	335	340	346
	Electronics	t	268	262	249	272	252	257	268	274	279	285
	Other Industrial	t	51	50	42	47	47	48	50	51	52	52
	Dentistry	t	15	14	12	11	10	10	10	10	9	9
	Investment	t	1,164	1,271	1,796	1,002	1,107	1,120	1,221	1,267	1,244	1,256
	Bar and coin	t	1,090	871	904	1,191	1,217	1,212	1,184	1,173	1,179	1,190
	ETFs & similar products	t	74	400	892	-189	-110	-92	37	93	65	66
	Central banks & other inst.	t	656	605	255	450	1,136	571	207	154	129	129
	Gold demand	t	4,445	4,355	3,678	4,013	4,741	4,222	4,089	4,147	4,159	4,212
	Year-on-year chg	%	4%	-2%	-16%	9%	18%	-11%	-3%	1%	0%	1%
	Investment/Implied Investment	t	330	522	1,048	670	13	663	917	783	776	673
	Total balanced demand	t	4,775	4,876	4,726	4,682	4,755	4,885	5,006	4,930	4,934	4,886

Source: WGC, Metals Focus, BMO Capital Markets

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Buy	Outperform	49.7 %	17.4 %	53.8 %	53.8 %	56.9 %	57.7%
Hold	Market Perform	47.8 %	14.2 %	42.3 %	44.4 %	40.6 %	37.5%
Sell	Underperform	2.5 %	25.0 %	3.8 %	1.5 %	2.0 %	4.8%

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