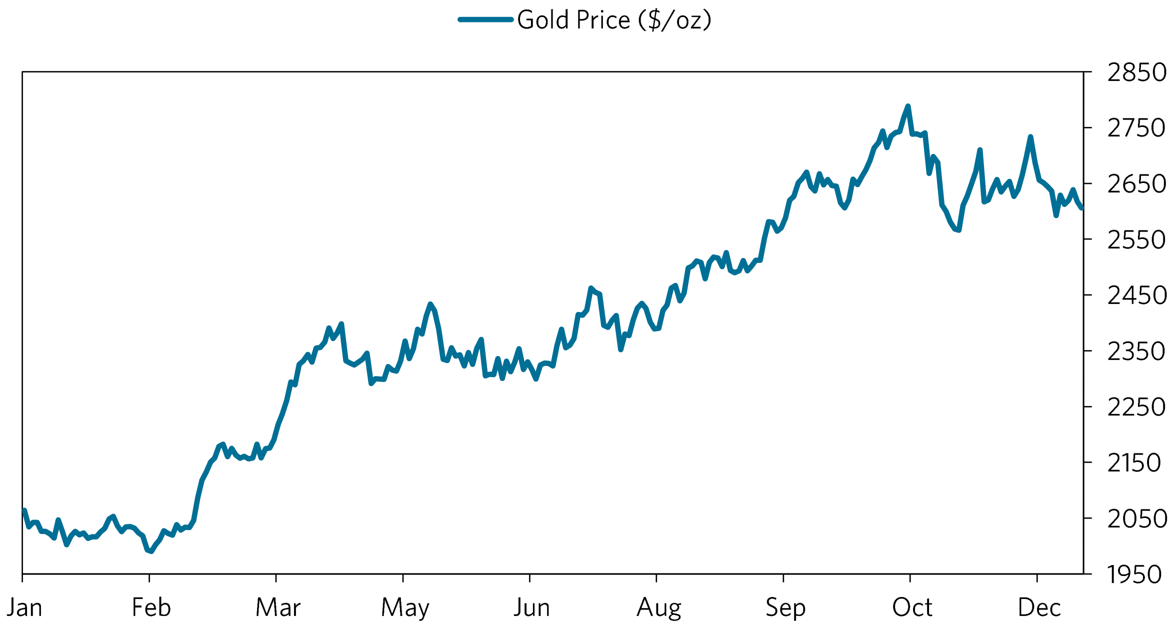
Gold Drivers and Outlook

4 January 2025

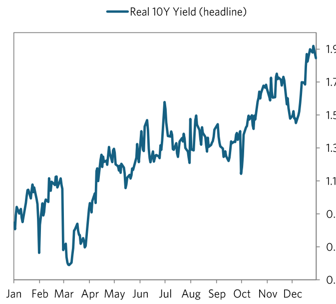
By: Will Infante

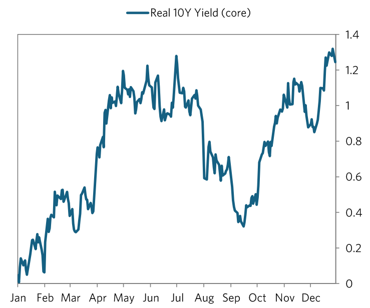
In 2025, gold rose roughly 30%, its greatest y/y change since 2010, and beating the S&P 500 by a percentage point. The increase was heavily driven by expectations of rate cuts by the Fed and ongoing global geopolitical risks, flowing into higher investment demand.



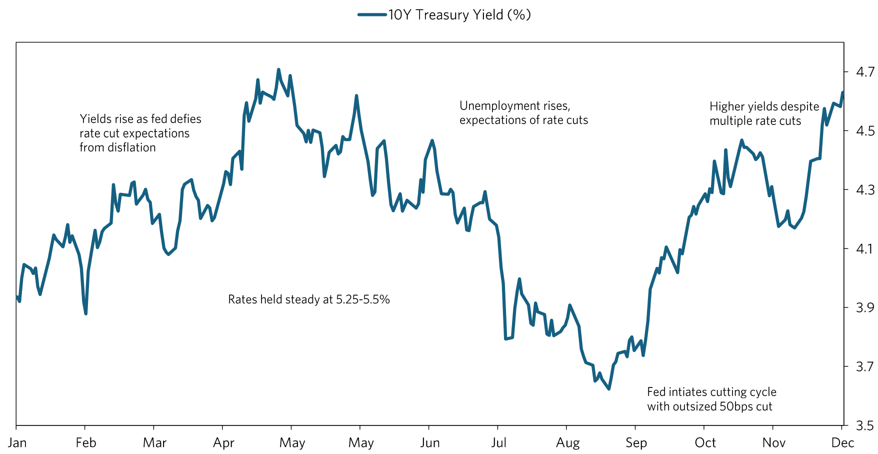
Yields

In the first half of the year, the 10-year nominal and real yields rose, moving in the same direction as the gold price. The rise in yields was possibly due to the Fed holding off on rate cuts and spooking traders about the potential for higher for longer. This unusual positive correlation was likely due to the Palestine-Gaza conflict in the Middle East.





However, once July began, the real and nominal 10-year yields began to fall, and the correlation reversed with gold rising rapidly. This decrease was likely due to expectations of rate cuts in the fall.



Once the Fed cut rates in September, yields began to increase. Since then, the benchmark rate has decreased by 100bps, while the yield on the 10 year has increased by around 100bps. The most likely explanation seems to be higher inflation expectations from tariff and immigration policies under the new president and worries about US government borrowings. I see the latter as less likely as the US debt level has been falling in GDP adjusted terms.

Geopolitical/Conflict Risks

Last year increased geopolitical risks were brought into focus. We started the year with escalation of the Israel-Palestine conflict, which likely was the reason why gold rose despite increased nominal/real yields. Another uncertainty this year was the then-upcoming presidential election, whose outcome was key for the future outlook of the US economy and foreign relations. Along with this, the war in Ukraine has continued on, with their recently having been reports of Ukraine firing missiles into Russian territory, and Putin raising his threshold for nuclear strike.

All Feeding into Investment Demand

The biggest driver of demand last year was investment, especially from ETFs and OTC trading. This means that the price action was mainly driven by the macro factors above that gold traders/investors look at, as opposed to factors such as jewelry demand that have been a negative catalyst for gold. Note that Q4 results are not out yet so I projected Q4 and subsequently the year end number using the average of the first 3 quarters.

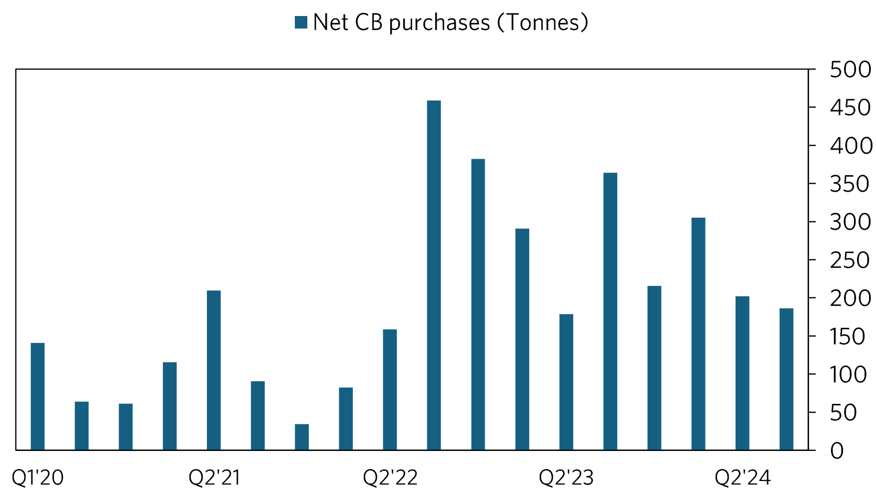
	2023A	2024E	% Change
Jewellery fabrication	2190.47	1983.88	-9.4%
Investment	945.33	1198.00	26.7%
Central banks & other inst.	1049.06	924.69	-11.9%
Technology	305.15	324.95	6.5%
Gold demand	4490	4431.52	
OTC and other	460.0	670.49	
Total demand	**4,950.0**	**5102.01**	

% Total Demand	Weighted Change
44.8%	-4.22%
27.0%	7.23%
20.9%	-2.47%
7.3%	0.48%
100.0%	**0.01**

Central Bank Demand

Demand from central banks has remained robust this year, with the biggest buyers being China, Poland, and Singapore. A quote from Adam Glapiński, the Governor of the Polish National Bank, gives us one of the reasons why many central banks are doing this:

"Gold will retain its value even when someone cuts off the power to the global financial system, destroying traditional assets based on electronic accounting records. Of course, we do not assume that this will happen. But as the saying goes – forewarned is always insured."



Singapore bought more for similar reasons, but China has been stocking up to hedge against sanctions like those experienced by Russia following their invasion of Ukraine. While the total amount of purchases seems to have slowed, they remain a factor in supporting the price of gold.

Consumer Demand

Other demand factors, such as consumer demand and central bank demand, have decreased this year. Golds top consumers, India and China, have struggled this year, most notably China, which has been experiencing deflationary problems for the past few years.

Looking forward:

The drop in November was in anticipation and realization of Trumps victory, which the market seemed to see as inflationary/pro-growth. Yields rose, with gold falling on the prospects of the Fed having to raise interest rates to keep inflation in check, helping the dollar. Along with this, there is a pro-dollar/industry idea behind his campaign, which also helped gold to fall. Yields fell off from mid-November to early December, supporting gold. The most recent development has been the Feds December 18 meeting, where they implied a more hawkish outlook for rates next year. Gold fell over 2% that day and has not gotten above its December high of $2,750 since then. Given gold fell following the election and the meeting, this means that the market believes that the Fed will be able to keep any coming inflation under control.

Negative catalysts

- China is still struggling despite stimulus packages. Chinas monetary policy efforts still differ vastly from the west, and their economy remains in a much different place than ours. For instance, China has a very high savings rate, as they don't have a strong healthcare or pension system. China has talked about putting money into these to increase spending in the short term. However, it is questionable whether the people will trust the new systems as stable enough.

- India's central bank recently slashed growth forecasts for 2024 yet held interest rates higher due to concerns over inflation. Despite what their central bank said about growth bottoming, I still feel it is likely that their higher discount rate and inflation will continue to weigh on their economy going into 2025.

- Treasury yields will likely remain elevated from inflation concerns, likely regarding tariffs this year. Even after the original effects of tariffs dissipate, I feel that the inflation will remain a problem, as companies in the US will have to either (a) pay for the Chinese goods with higher tariffs or (b) pay more expensive US workers to produce the goods, both being inflationary. Absent any major negative event in the US, higher yields will put pressure on gold.

- I don't see a whole lot of upside in gold from a potential inflation spiral, as Powell has signaled that rates are still 'contractionary'. Should inflation continue to tick up, the Fed can easily raise rates even higher without any worry about not being contractionary enough in the near term due to policy lags. Powell should be able to keep inflation under control, which will keep gold prices suppressed, regardless of there being more inflation pressures. If we were not currently contractionary, I would be more bullish on gold.

- The increases in the money supply should slow down, as the fed is only projecting two interest rate cuts in 2025, which would weigh on gold.

- Central bank purchases remain elevated from their pre-Russia/Ukraine war lows. However, it appears that this theme has become overplayed. There are some reports about how China has been buying up more gold than they report. This would put even more pressure on the outlook for central bank purchases. The unreliable metrics posted by China lead me to believe that less weight should be given to individual readouts of this indicator.

Positive catalysts

- In 2025, gold is likely to be supported by ongoing geopolitical conflict/risk. However, the outlook of this is highly contingent on what President Trump will do about foreign conflict once he gets into office. This would suggest volatility until the market gets certainty over what direction he will be taking.

Overall, I foresee gold being rangebound and slightly down (2400-2600), being pressured by continued slower demand, higher interest rate outlooks, yet with an uncertain outlook to buying from a geopolitical risk standpoint. The geopolitical situation should be ongoingly assessed to ascertain its impact on gold prices.

Risks to this outlook include:

a) A drop in headline/core inflation, which would cause the fed to be more dovish, which would support gold. (not as likely given the tariffs situation)
b) Increases in central bank gold reserves from escalated geopolitical conflict
c) A reaction lower in treasury yields following a more hawkish policy move by the Fed in anticipation of future cuts from weakness would upturn this view. Market beliefs of 'higher for longer' counteract this risk.
d) Political risks from 7 trillion of US debt set to mature next year which could pressure Powell to lower interest rates.
e) Investors making their decisions more off of geopolitical risks vs interest rates

Data Sources: Yahoo Finance, World Gold Council