Hungary’s central bank rekindles with gold

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While futures markets were shorting gold, Hungary’s central bank was quietly accumulating physical gold bullion in the first two weeks of October 2018. The Magyar Nemzeti Bank (MNB, Hungary’s central bank), announced on 16 October that it had increased its holdings of gold to 31.5 tonnes in the first two weeks of October. That is a ten-fold increase from 3.1 tonnes it had previously (source: MNB). It is a big step for a central bank that had kept a flat level of 3.1 tonnes for the last 32 years (i.e. since 1986, source: MNB). According to the central bank, its holdings of gold has risen to 4.4% of foreign exchange reserves (up from 0.4% in September 2018 according to World Gold Council statistics).

By bringing its gold holdings back to the level last seen in 1946 (source: MNB), the MNB appears to have renewed its faith in gold. On its website it commented, “Preserving its historical role, gold continues to be one of the safest assets in the world, which enhances stability and confidence even under normal market circumstances”. The central bank also transported all the gold back to Hungary – a move that appears to be popular with many central banks these days after Bundesbank started a repatriation trend in 2013.

Up until developed market equities faltered in the second week of October, there appeared to be heavy negative sentiment towards gold. Futures market net speculative positioning had reached its lowest level since February 2001 last week. Commodity Futures Trading Commission (CFTC) data on futures market positioning released last Friday relates to last Tuesday positions. Only on 19 October 2018 will we see if those heavy shorts were indeed covered, but based on gold price moves, we expect that there was strong short-covering activity.

So, did the Hungarian central bank know of something that the futures market did not? Probably nothing specific, but we have long argued that futures markets have been under-pricing many geological risks that exist in Europe and beyond. In the same way as the MNB has increased its holdings of gold back to levels comparable with other non-euro area Central and Eastern European countries, we expect futures markets to return positioning back to ‘normal’ levels (i.e. closer to 100,000 contracts net long rather than 52,000 contract net short). That should act as a tailwind for gold prices.

The MNB highlights many of gold’s virtues, including it historically being a defence for extreme market conditions or geopolitical crises. Also, its lack of credit and counterparty risk appears to be one of its attractions to the central bank. That could become important if it fears other central banks could slip into a currency war as trade frictions continue to pressure their economies.

We believe we have reached a turning point in sentiment toward gold. In our recent outlook (Gold Outlook: Upside Correction Due, September 2018), we articulate why we think that gold prices are likely to rise above US$1320/oz this time next year (from US1224/oz today, source: Bloomberg).

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