GOLD OUTLOOK TO Q2 2024: Recession Risk Increasing as Central Banks Continue to Slam on the Brakes

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US INFLATION IS FALLING

US inflation is arguably falling hard. However, the stale shelter data in the Consumer Price Index (CPI) calculation masks the reality. An alternative inflation metric, calculated by WisdomTree (that substitutes real time housing metrics for shelter inflation), reads at 1.4% instead of the 4.1% official Bureau of Labor Statistics (BLS) headline inflation, with core inflation using real time metrics running at 2.1% - almost exactly the Federal Reserve’s (Fed) target inflation. The official BLS reports use a shelter inflation metric which is running at 8% over the last 12 months. However, our alternate metric puts the shelter price increase at 0.5%. This single variable change would dramatically alter the Fed’s inflation narrative and shows the Fed should be done hiking.

However, Fed dot plots indicate that members of the Federal Open Market Committee (FOMC) expect several more rate hikes to come. That could potentially overdo it and raises the risk of recession.

Other developed world central banks appear far from done in their respective hiking cycles. The European Central Bank (ECB) maintains a hawkish stance and has warned markets of more hikes to come, with President Lagarde saying that they have made “significant progress” but “cannot declare victory yet.” The Bank of England (BoE) has resorted to shocking the market with 50 basis points (bps) hikes as upside inflation surprises persist. While we don’t think that the inflation metrics in Europe share the same shelter price distortions as in the US, we know that monetary policy lags are long and variable. The rapid pace of rate hikes could have an outsized impact once the lag is accounted for.

1 27 June 2003.
RECESSION RISK RISING

With recession risks rising, investors could look to gold as a defensive asset. One measure of recession risk, based on yield curve inversions\(^2\), indicates a 70% chance that the US economy will be in recession in mid-2024 (Figure 1). The Federal Reserve Bank of New York model has had a fairly good track record of pinning down past recessions, and so it’s hard to ignore this warning sign.

Source: WisdomTree, The Federal Reserve Bank of New York. Data from January 1962 to May 2023, with forecasts extending to May 2024. NBER = National Bureau of Economic Research. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

\(^2\) The Federal Reserve Bank of New York model which uses the term spread between 10 year and three-month Treasury yields to forecast recession 12 months out.
GOLD: A HAVEN IN TIMES OF ECONOMIC STRESS?

Gold tends to perform well in times of economic stress. As Figure 2 below shows, when composite leading indicators (Figure 3) turn strongly negative, gold performs positively while equities tend to be negative. Gold also outperforms Treasuries, which are seen as competing defensive assets.

Source: WisdomTree, Bloomberg, Organisation for Economic Cooperation and Development. Period June 1989 to May 2022. The composite leading indicator (CLI) is designed to provide early signals of turning points in business cycles, showing fluctuation of the economic activity around its long-term potential level. CLIs show short-term economic movements in qualitative rather than quantitative terms. CLI is amplitude adjusted, Long-term average = 100. Figure 3 shows when the strength of the signal while Figure 2 shows the historic asset price performance. Calculations are based on monthly returns in EUR. Europe Equities is proxied by the STOXX Europe 600 Net Total Return Index. Global Equities is proxied by the MSCI World Net Total Return Index. EUR Treasury is proxied by Bloomberg EUR Treasury TR Index Family. Gold is proxied by the LBMA Gold Price PM Index. Historical performance is not an indication of future performance and any investments may go down in value.
CENTRAL BANKS LAPPING UP GOLD

After hitting an all-time high in 2022, central bank demand for gold has maintained strong momentum. Figure 4 shows official sector gold buying in Q1 2023 was the largest on record for the first quarter (albeit lower than Q3 2022 and Q4 2022). In April 2023 gold sales by Turkey’s central bank of 81 tonnes appears to be more of a technical dynamic than a change in gold buying policy: the gold was sold to the domestic public markets to satisfy strong bar, coin, and jewellery demand following a temporary partial ban on gold bullion imports. That ban was put in place to soften the economic blow from the earthquake in February 2023. A YouGov poll, sponsored by the World Gold Council\(^3\), showed that developing market central banks are expecting to increase their gold reserve holdings and decrease their US dollar reserve holdings.

![Figure 4: Central Bank Gold Purchases by Quarter](image)


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LOOKING BACK AT GOLD

If we look to WisdomTree’s quantitative gold model⁴ to find out what has been driving gold prices recently, we can see that inflation is moderating, thus providing less support for gold prices than last year (Figure 5). The recovery in investor sentiment towards gold (measured by speculative positioning) has largely plateaued. The extension of the debt ceiling, and the passing of the mini banking crisis without any major systemic impacts (yet), has softened investor demand for the metal. However, dollar depreciation (relative to a year ago) acts as a support for the metal.

Figure 5: Gold Price Attribution in WisdomTree Model

Source: Bloomberg, WisdomTree price model, data as of June 2023. The fitted gold price is the price the model would have forecast. The constant does not have economic meaning but is used in econometric modeling to capture other terms. It can be thought of as how much gold prices would change if all other variables are set to zero (although that would be unrealistic). Historical performance is not an indication of future performance and any investments may go down in value.

⁴ See our model described in Gold: how we value the precious metal.

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GOLD OUTLOOK USING WISDOMTREE’S FORECASTS MODEL

Using the same model, we can produce gold forecasts consistent with several macroeconomic scenarios (Figure 6).

CONSENSUS

Our consensus scenario takes Bloomberg Survey of Professional Economists’ average views on inflation, US dollar and Treasury yield forecasts. Consensus is looking for inflation to continue to decline (although above central bank target), the US dollar to depreciate, and bond yields to continue to fall.

Without a consensus forecast on gold sentiment we reduce speculative positioning to a conservative 100k, which is close the long-term average, from the elevated level of close to 180k in June 2023. The risk is clearly to the upside this year if a recession or financial dislocation materialises. Gold is a highly sought after asset in times of economic and financial stress, and so a recession could drive sentiment for the metal even higher.

In the consensus case scenario, gold reaches US$2,225/oz by Q2 2024, piercing through previous all-time nominal highs (US$2,061/oz on 7 August 2020) by Q4 2023 at $2139/oz. However, in real terms this does not reach an all-time high, which was reached in January 1980. In fact, it would be 34% below that level. And, in real terms, it is still 10% below the 2020 high.

BULL CASE

In this scenario the Federal Reserve pays heed to the recession warning signs and pivots its monetary policy to cutting rates faster. If the Fed begins monetary expansion by autumn 2023, bond yields will be falling and, assuming it moves before the European Central Bank and other major central banks, we could see the US dollar depreciate at a faster rate. We assume inflation will be stronger than in the consensus scenario as a result of the Fed loosening monetary conditions. Assuming that the recession fears that the Fed is responding to are real, we expect positioning in gold futures to remain elevated.

In this scenario, gold could reach US$2490/oz. That would be 22% higher than the all-time nominal high (reached in August 2020) and about the same level as that in real terms. However, it would be 28% below the all-time real high reached in 1980.
**BEAR CASE**

In the bear case, CPI inflation falls to 1.8%, that is, below the Fed target. In essence, the Fed makes a policy error in overdoing the tightening. Bond yields rise and the US dollar appreciates as an overzealous Fed outpaces other central banks. Although we acknowledge that such a scenario increases recession risk and, therefore, could be gold positive drawing more investors to the yellow metal as a hedge, for the sake of building a negative scenario, we cut speculative positioning in gold futures down to 50k.

In this scenario, gold could reach US$1710/oz, retracing prices back to November 2022 levels.

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**Figure 6: Gold Price Forecasts**

Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close June 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

<table>
<thead>
<tr>
<th></th>
<th>Consensus Q3 2023</th>
<th>Consensus Q4 2023</th>
<th>Consensus Q1 2024</th>
<th>Consensus Q2 2024</th>
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<tbody>
<tr>
<td>Inflation forecast</td>
<td>3.5%</td>
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<td>Nominal 10-year yields forecast</td>
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<td>150k</td>
<td>125k</td>
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</table>

Source: WisdomTree. Bloomberg Survey of Professional Economists, April 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.** Speculative positioning is the number of long non-commercial contracts in gold futures and options less the number of short non-commercial contracts in gold futures and options. A non-commercial holder is someone who has no operational business activities related to a particular commodity (e.g. not a miner, refiner or jewellery company). They are typically financial counterparties or investors and thus labelled speculators. The net positioning of their contracts provides an indication of financial market sentiment for the commodity.
### Bull Q3 2023

<table>
<thead>
<tr>
<th>Forecast</th>
<th>Bull Q3 2023</th>
<th>Bull Q4 2023</th>
<th>Bull Q1 2024</th>
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<tr>
<td>Inflation forecast</td>
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<td>US$ exchange rate forecast (DXY)</td>
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</table>

Source: WisdomTree, June 2023. Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

### Bear Q3 2023

<table>
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<tr>
<th>Forecast</th>
<th>Bear Q3 2023</th>
<th>Bear Q4 2023</th>
<th>Bear Q1 2024</th>
<th>Bear Q2 2024</th>
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<tr>
<td>Inflation forecast</td>
<td>3.0%</td>
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<td>Speculative positioning forecast</td>
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Source: WisdomTree, June 2023. Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.
Glossary

Basis point: 1/100th of 1 percent. Bear market: A sustained downturn in market prices, increasing the chances of negative portfolio returns. Bloomberg EUR Treasury TR Index Family: Family of indexes consisting of fixed-rate, investment-grade public obligations of the sovereign countries participating in the European Monetary Union. Bond yield: Refers to the interest received from a bond and is usually expressed annually as a percentage based on its current market value. Bull market: A market in which share prices are rising, encouraging buying. Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Core CPI excludes food and energy costs. Core inflation: Inflation excluding the impact of food and energy. Federal Open Market Committee (FOMC): The branch of the Federal Reserve Board that determines the direction of monetary policy. Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States. Gold futures: Standardized, exchange-traded contracts in which the contract buyer agrees to take delivery, from the seller, a specific quantity of gold at a predetermined price on a future delivery date. Hawkish: Description used when worries about inflation are the primary concerns in setting monetary policy decisions. Inflation: Characterized by rising price levels. LBMA Gold Price PM Index: Measures the performance of setting price of gold. Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates. MSCI World Net Total Return Index: A broad global equity index that represents large and mid-cap equity performance across all 23 developed markets countries. Recession: Two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment. STOXX Europe 600 Net Total Return Index: A stock index of European stocks designed by STOXX Ltd. This index has a fixed number of 600 components representing large, mid and small capitalization companies among 17 European countries. Treasury (UST): Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government. Yield curve inversion: An interest rate environment in which long-term debt instruments have a lower yield than short-term debt instruments of the same credit quality. Yield curve: Graphical depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis. Yield: The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

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