

Global Precious Metals Comment

Dovish central bank policies support gold

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Global

Macro view intact

There have been three key central bank policy announcements over the past couple of weeks: the Fed, BOJ and BOE. The reaction of financial markets to each outcome depended to a large extent on expectations heading into the event. While there have been some disappointments and risks to the view of more policy accommodation and lower yields for longer (BOJ under-delivering and Japanese yields exerting upward pressure to global yields), overall we think the regime has not changed. As such, the macro story for gold remains intact.

Gold, the BOJ and Japanese yields

The dissatisfaction with the BOJ outcome was evident in the sell-off in USDJPY and JGBs. One risk that this poses for gold is the impact this would have on policy expectations in Japan and elsewhere. Another risk is if stronger fiscal measures are taken without a clear monetary policy response – this would push real rates higher. In turn higher Japanese yields would exert upward pressure on US yields and weigh on gold. While we don't expect a change in regime for global yields, spikes are likely to lead to downside in gold in the near term. We would view these bouts of weakness as potential buying opportunities. Ultimately, higher US yields are likely to trigger tighter financial conditions and an increase in risk aversion – we would expect gold to do well in this environment.

Gold, the BOE and UK real yields

Although a weaker GBP against the dollar may somewhat complicate gold's reaction function, the path of monetary policy in the UK should ultimately have a stronger fundamental impact. The dovish BOE outcome this week is supportive for gold in our view, and in a sense offsets some of the concern around BOJ disappointment. Weaker growth outlook and lower real yields – especially with potential tolerance for inflation to overshoot – in a sense reinforce the themes that have driven investors towards gold this year.

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Dovish central bank policies support gold

There have been three key central bank policy announcements over the past couple of weeks: the Fed, BOJ and BOE. The reaction of financial markets to each outcome depended to a large extent on expectations heading into the event. Despite a more optimistic tone from the Fed, the US dollar weakened, yields eased and gold rallied as the FOMC outcome fell short of markets' hawkish expectations. The BOJ choosing to ease by increasing ETF purchases and via dollar funding was a let-down for market participants given expectations were set quite high. Meanwhile, the BOE outcome was in line with the UBS view, delivering a 25bp rate cut and £70bn of asset purchases, which was more than what the market was anticipating. While there have been some disappointments as well as risks to the view of more policy accommodation and lower yields for longer (BOJ under-delivering and Japanese yields exerting upward pressure to global yields), overall we think the regime has not changed. As such, the macro story for gold remains intact.

Gold, the BOJ and Japanese yields

The dissatisfaction with the BOJ outcome was evident in the sell-off in USDJPY and JGBs. One risk that this poses for gold is the impact this would have on policy expectations in Japan and elsewhere. Japan moving into negative rates territory earlier this year and talk of the possibility of 'helicopter money' were important developments that pushed investors towards gold. The scaling back of expectations around these measures could potentially weigh on gold.

However, our Japan economists note that the BOJ is still well behind its inflation target and corporate sentiment is not sufficiently robust – the latest measures do not appear strong enough to achieve the desired results. More is likely needed, and our colleagues think that the announcement of a thorough assessment of current policy measures could mean that the government and the BOJ may be working on a new framework for easing. If stronger fiscal measures are taken, without a clear monetary policy response, the risk for gold is that real rates could tick higher. Higher Japanese yields exert upward pressure on global yields, and the impact on US rates in particular acts as a threat to gold.

Our core positive view on gold hinges on the expectation that real rates are likely to settle lower during this cycle. An environment where real rates rise sustainably could therefore be a significant threat (see [Helicopter turns submarine: Japan's bond sell-off and its global effects](#)). In Macro Strategy we estimate that if Japanese yields return to levels at the start of the year, this could lift US 10y yields by around 20bp, and potentially another 20bp lift coming from higher German yields. This would be a material move, which could weigh on gold in the near term. However, we would view these bouts of weakness as potential buying opportunities given that 1) we don't view these possible spikes in yields as a regime change and 2) sluggish growth and disinflationary pressures suggest that these are likely to be short-lived. This is likely to trigger tighter financial conditions and higher levels of risk aversion, which should weigh on yields and in turn be positive for gold.

BOJ under-delivers – disappointment creates downside risks for gold if it affects policy expectations elsewhere

Impact of higher Japanese yields on global yields could lead to gold downside – buy these dips

Gold, the BOE and UK real rates

Although a weaker GBP against the dollar may somewhat complicate gold's reaction function, the path of monetary policy in the UK should ultimately have a stronger fundamental impact. The dovish BOE outcome this week is supportive for gold in our view, and in a sense offsets some of the concern around BOJ disappointment. Not only did the BOE deliver more than what the market was expecting, they also left the door open for more policy easing measures – the UBS house view is now for rates to be cut further to 0.10% in November. We expect the weakness in the GBP and the decline in Gilts yields to extend (see [Bank of England eases with a vengeance](#)).

BOE over-delivers – lower yields are positive for gold

The BOE altered growth and inflation forecasts dramatically – the direction of these changes reinforces gold's appeal. The BOE's growth forecasts, which are sharply lower, in a sense validates the concerns around the UK referendum outcome, albeit Eurozone and UK PMI prints thus far suggest that the shock is more localised. The upward pressure on inflation expected over the next 2-3 years, as a result of a weaker currency, against the backdrop of lower yields suggests further downside for real rates. Additionally, the potential tolerance for inflation overshooting adds to the perception of central banks being 'behind the curve', which is in general supportive for gold.

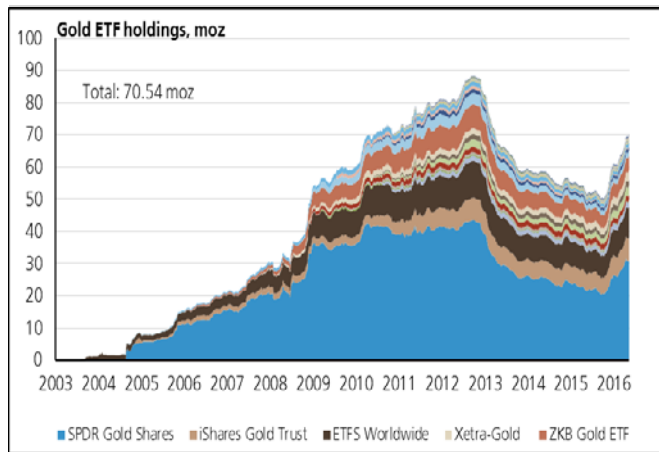
Figure 1: Precious Metals Global ETF holdings – PGM Holdings Decline

Date	Gold (in Moz)	Silver (in Moz)	Platinum (in Koz)	Palladium (in Koz)
4-Aug-16	70.54	665.39	2476.98	2191.75
Daily Change	0.17	-0.24	-2.77	-6.23
MTD Change	0.72	0.99	1.46	-66.99
YTD Change	20.36	52.44	-81.45	-199.20

Source: Various ETFs, UBS

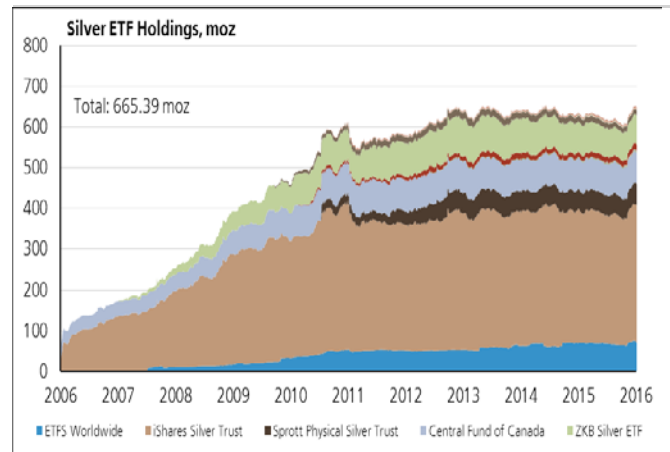
Gold holdings increased by 0.17moz to 70.54moz. This increase was largely due to investors adding to their holdings in the SPDR fund (115koz), the iShares (NYSE) fund (24koz) and the ETFS (LSE) fund (22koz). Silver holdings decreased by -0.24moz to 665.39moz due to decline in holdings in the ETFS (LSE) fund (239koz). Platinum holdings decreased by 2.77koz to 2476.98koz due to outflows from the ETFS (LSE) fund (3koz). Palladium holdings decreased by 6.23koz to 2191.75koz due to outflows from the ETFS (LSE) fund (6koz).

Figure 1: Gold ETFs



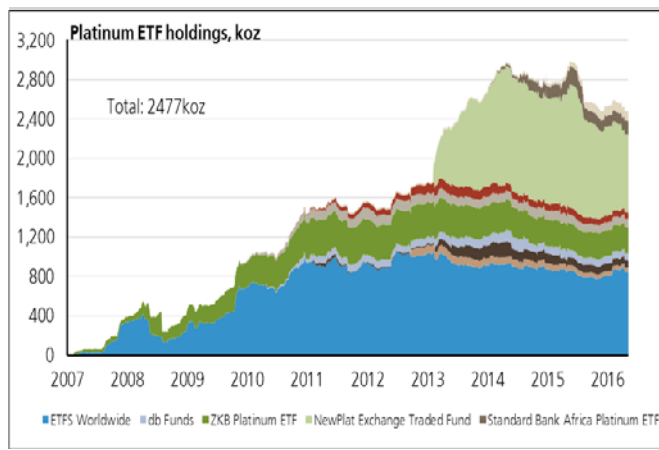
Source: Bloomberg, various ETF websites, UBS

Figure 2: Silver ETFs



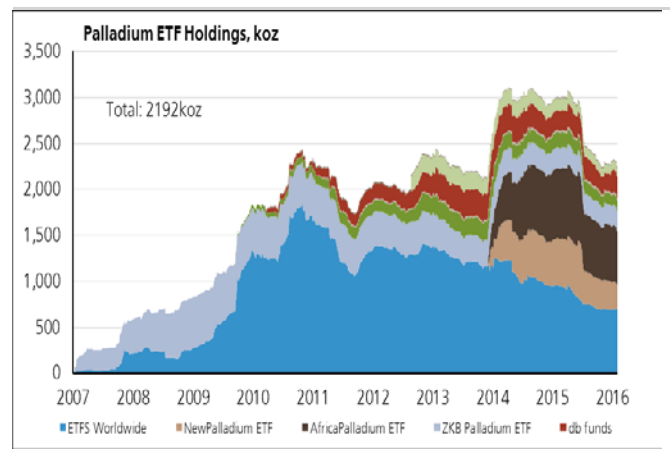
Source: Bloomberg, various ETF websites, UBS

Figure 3: Platinum ETFs



Source: Bloomberg, various ETF websites, UBS

Figure 4: Palladium ETFs



Source: Bloomberg, various ETF websites, UBS

Figure 2: Precious Metals: Palladium Sees Bearish Activity

05-Aug-16	GOLD	SILVER	PLATINUM	PALLADIUM
Spot Price	1363.93	20.40	1164.20	703.30
5 Days MA	1360.01	20.45	1162.32	710.58
10 Days MA	1346.27	20.24	1140.91	703.78
20 Days MA	1339.85	20.13	1118.04	678.88
50 Days MA	1308.69	18.68	1049.36	610.22
100 Days MA	1278.05	17.54	1028.17	593.72
200 Days MA	1204.82	16.05	960.71	565.70
Resistance	1375.45	21.14	1178.15	724.40
Support	1310.85	19.96	1127.55	650.00

Source: UBS

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