ECONOMIC VIEWPOINT

Why Do Gold Prices Keep Setting New Records?

By Marc-Antoine Dumont, Senior Economist

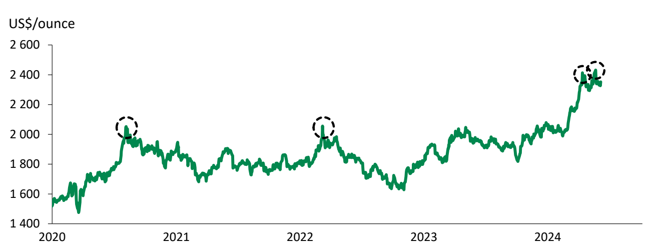
- In this Economic Viewpoint, we'll be looking at what's behind the recent surge in gold prices.
- While a number of factors have contributed, there's no one clear reason we can point to. Uncertainty often pushes prices up—but the risks of a recession or stock market correction have softened lately. Geopolitical tensions remain heightened, but aren't enough to support such a gain.
- Central bank demand for gold has also ballooned over the last five years, from 14% to 23% of total gold demand. While de-dollarization has spurred some of this demand, with countries seeking to protect themselves against any weaponization of the US dollar, this support is merely reinforcing the trend that began after the 2008 financial crisis.
- The usual economic indicators—inflation, the US dollar, stock indexes and US 10-year Treasury Inflation-Protected Securities yields—are no longer providing any real explanation for gold's performance. In fact, the historical relationship between real yields and gold prices seems to have broken down.
- We believe that as inflation converges toward central bank targets and interest rates are cut, especially in 2025, the price of gold should gradually lower. All of this puts our end-of-year forecasts at US$2,100 per ounce for 2024 and US$1,900 per ounce for 2025.

Gold Prices Have Been Surging

Gold prices have hit new highs in recent years, breaking records in 2020, 2022 and 2024 (graph 1). Each time, there were exceptional circumstances driving investors towards safe havens: the pandemic, the war in Ukraine, and now stubborn inflation and conflict in the Middle East. The price of the precious metal has gone up more than 50% since early 2020, making it one of the best-performing asset classes on the market.

All the same, gold's popularity with private investors has waxed and waned over the years, as shown by gold exchange-traded fund (ETF) holdings. While these holdings jumped in 2020, they've since calmed back down (graph 2 on page 2). On a global level, it would seem that the situation in the Middle East, beginning with the attack by Hamas in October, did not influence private investment decisions in the initial months. While we've seen strong growth since March 2024, it's primarily due to higher gold prices. In tonnes, gold holdings in ETF accounts have actually pulled back 0.8% in that same period.

Graph 1
The Price of Gold Continues to Set New Records



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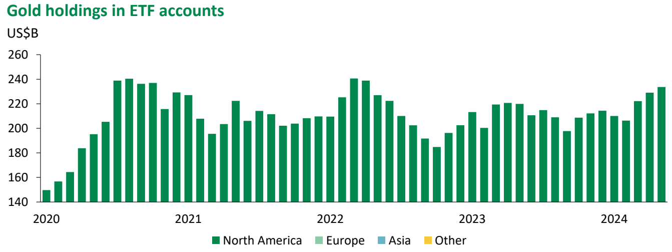
Graph 2
Investor Appetite for Gold Has Increased



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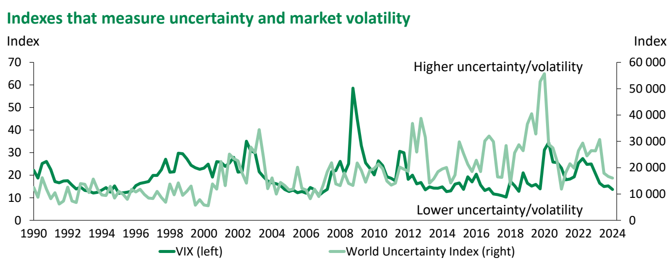
Uncertainty Can't Explain It All

First of all, it's hard to define "uncertainty"—and it's even harder to measure it. Some indexes make an attempt, like the [VIX](), which tracks US stock market volatility, or the [World Uncertainty Index](), which tracks geopolitical and economic uncertainty, but their measurements are not perfect (graph 3). Uncertainty isn't tangible and much of it hinges on individual perception. That being said, we generally consider wars, recessions and periods of high inflation to be "uncertain times". In other words, it's when the future seems harder to predict than usual. And we're still in uncertain times. While a recession and stock market correction do seem less likely, there are still concerns about hitting the inflation target, and geopolitical tensions persist. The price of gold is clearly benefiting from this uncertainty, but that can't fully explain the impressive gains we've observed.

Graph 3
The VIX and World Uncertainty Index Have Been Declining since Mid-2023



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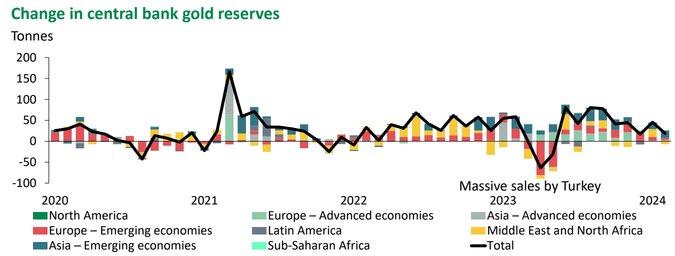
Central Bank Appetite Plays a Role

Part of the answer might be that central bank demand for gold has been growing. Since mid-2022, central banks have accelerated their gold purchases (graph 4). Reserves took a brief nosedive in April and May of 2023, when Turkey sold off 100 tonnes of gold, but have since recovered. Most of the recent gains come from emerging economies in Europe and Asia. Net central bank purchases account for an ever-larger share of total global gold demand, going from 14% in 2019 to 23% in 2023 (graph 5). It's worth noting that growth by total demand was rather moderate over this same period: investment demand shrunk from 30% to 21%.

Graph 4
Central Banks in Emerging Economies Are Buying the Most Gold



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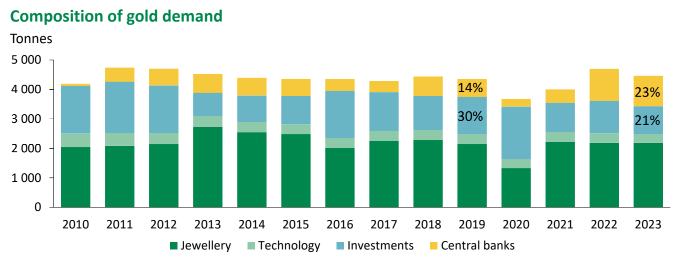
Graph 5
The Central Bank Share of Total Gold Demand Has Jumped Sharply Since The Pandemic



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However, this sustained demand from central banks isn't that easy to break down. In the current environment, many countries are turning to gold as a hedge against inflation and geopolitical risk. And since the United States can use its dollar as a weapon—for example, by imposing sanctions like those on Russia—some countries are seeking to reduce their reliance on the US currency, especially if they expect or worry sanctions will be levied against them. That being said, these factors are contributors, but not the main drivers of the upward trend that was already well underway. Since the 2008 financial crisis, central banks have increasingly turned to gold as a way to diversify their reserves and maintain a more balanced risk profile. The bright metal is still a very stable and fairly liquid asset. All the same, it can't fully explain the recent surge in gold prices. We're missing some pieces of the puzzle.

Historical Correlations Aren't Yielding Clear Answers

Gold's price movements are often viewed as the result of fluctuations in other economic and financial indicators. Those indicators include the US dollar, stock indexes, inflation, and perhaps most importantly, real yields on US Treasury Inflation-Protected Securities (yields adjusted for inflation). But some of these historical paradigms, in place for several decades, seem to have shifted or broken down.

Inflation

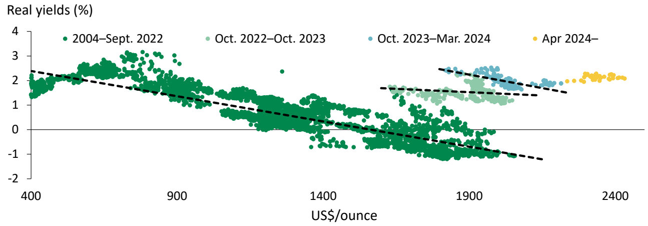
Gold has traditionally served as a hedge against inflation. When price growth heats up, investors can buy gold to protect their portfolio returns. The United States has been slow to return to target inflation, which certainly gave gold prices a boost. But elsewhere in the world, including Canada and the euro zone, inflation continues to decelerate: this should have had the opposite effect on the price of yellow metal. But the war against inflation hasn't been won yet, and many investors still seem to doubt the central banks' ability to curb inflation over the next few years.

Yields on US 10-Year Treasury Inflation-Protected Securities

TIPS yields combine all of the factors mentioned in this section with the broader economic climate (real GDP, employment, public finances, etc.). They can also be considered the opportunity cost of holding onto gold, since gold doesn't earn any interest. So it's relevant to examine them in greater detail.

Historically, when the yields on US 10-year Treasury Inflation-Protected Securities (10-year TIPS) go up, gold prices go down. Under this paradigm, when the real yields increased in response to tighter monetary policy and deteriorating economic conditions in 2022, gold prices should have moved along their usual curve (graph 6). Instead, they bucked their historical trend and rose when they should have fallen. That meant that the decades-long inverse relationship between gold prices and these yields was shifting. And even more recently, gold prices and the 10-year TIPS yield both went up, suggesting that the relationship has broken down. Time will tell if this is just a passing phase. Even when we adjust the price of gold for inflation, we get a similar result (graph 7): the relationship has been reversing since April.

Graph 6
The Relationship between Bond Yields and the Price of Gold Remains Inverted, but It Flattened Last Year
Relationship between the 10-Year Treasury Inflation-Protected Security Yield and the price of gold



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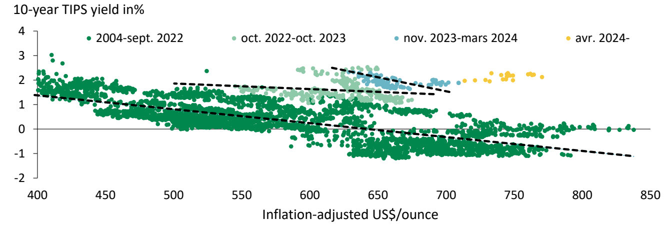
Graph 7
Even When the Price of Gold Is Adjusted for Inflation, We See the Changing Correlation with the 10-Year TIPS yield*
Relationship between the 10-Year Treasury Inflation-Protected Security yield and the price of gold



10-year TIPS yield: Yields on US 10-Year Treasury Inflation-Protected Securities
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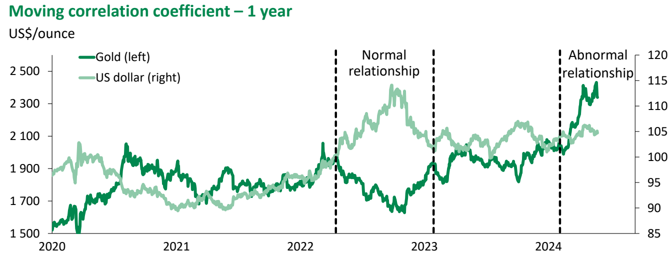
US dollar

Gold prices generally also have an inverse relationship with the value of the US dollar. All else being equal, a strong US dollar tends to go hand-in-hand with lower commodity prices, including gold. And when the dollar is weaker, gold prices often go up, as they're expressed in US dollars. Both gold and the US dollar can be considered safe havens: financial assets with a very stable values even during times of economic, financial and geopolitical crisis. While both can appreciate in times of crisis, their gains aren't usually of the same magnitude. Like the price of gold, the value of the US dollar moves in response to fluctuations in interest rates, inflation and the general economy. At some times, these variables will be aligned in a way that favours gold, like during the current inflation surge. At other times, such as during the European sovereign debt crisis in 2012, the dollar will benefit more. But now, the greenback value is riding high... and at the same time, the price of gold has been soaring (graph 8).

Graph 8
The US Dollar Has Appreciated, But Gold Prices Have Soared

Moving correlation coefficient – 1 year



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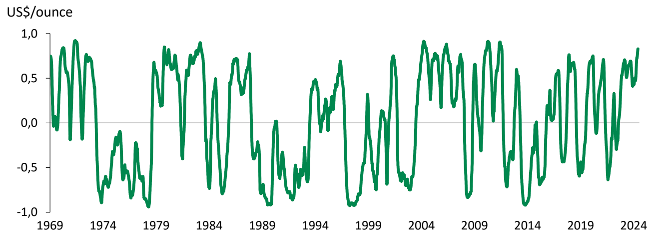
Stock market indexes

The relationship between the price of gold and the stock market indexes is more unusual. In times of crisis, poor market performance generally raises the price of the precious metal. But in calmer times, market gains can also cause price growth. Taken at face value, it looks like prices go up no matter what, which makes no sense. And that's because the stock market isn't the key variable here. Instead, we should be looking at uncertainty, interest rates and inflation. Market indexes like the S&P 500 reflect the changes in those variables. This is apparent as soon as we try to map out the correlation between gold prices and the S&P 500. Although this is somewhat of a foolish exercise, it still shows that the relationship is highly unstable over time (graph 9).

Graph 9
The Relationship Between Gold Prices and the S&P 500 Is Very Unstable Over Time
Moving correlation coefficient – 1 year



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No Answer Is an Answer

Even if we take everything discussed above, and factor in market speculation, we can't explain it all. There's no obvious reason for gold prices to be gaining so much ground. But we're in unusual times. Look at the economic and financial conditions present worldwide, as well as the broader geopolitical climate. We've gone through a pandemic, the highest inflation in 50 years, slight de-globalization, spiking interest rates, the energy crisis and the first war on European soil in 30 years—to name just a few of the events that drove the price of gold higher. These price shifts can't be fully explained by the usual fundamentals, and there is no clear answer to why the price of gold has taken off so spectacularly.

What's in Store for the Rest of 2024 and 2025?

Right now, the price of gold stands at US$2,300 per ounce, which suggests that gold is currently overvalued and we may see some slight correction in the short term. But that doesn't mean it will fall back down to its pre-pandemic price of around US$1,500 per ounce. If we predicted the average price of gold for 2024, using nothing but the current relationship that shifted in April, we'd wind up with something close to US$2,400 per ounce (table 1). If we used nothing but the historical relationship, the average price would fall between US$850 and US$1,070 per ounce. Neither of these options paints an accurate picture, though.

We believe that as inflation converges toward central bank targets and interest rates are cut, especially in 2025, the price of gold should gradually lower. In addition, the recent boom in mining investment, especially in exploration, will accelerate the increase in supply over the next few years, which will also weigh on prices. That said, some things won't change. Purchases by central banks, especially those of emerging economies, and geopolitical uncertainty will continue to sustain gold prices. All of this puts our end-of-year forecasts at US$2,100 per ounce for 2024 and US$1,900 per ounce for 2025.

Table 1
The Changing Relationship Between Gold Prices and Bond Yields Points to Higher Prices for the Precious Metal

TREND CURVE	FORECAST FOR NOMINAL GOLD PRICES IN 2024 ($US/OUNCE)	
	RELATIONSHIP BETWEEN THE NOMINAL PRICE OF GOLD AND 10-YEAR TIPS YIELDS	RELATIONSHIP BETWEEN THE REAL PRICE OF GOLD AND 10-YEAR TIPS YIELDS
Historical trends	850	1,070
Oct.2022–Oct. 2023	435	1,240
Nov.2023–March 2024	1,940	2,015
Apr. 2024–	2,400	2,375
Desjardins	**2,190**	**2,190**

10-year TIPS yield: Yields on US 10-Year Treasury Inflation-Protected Securities
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