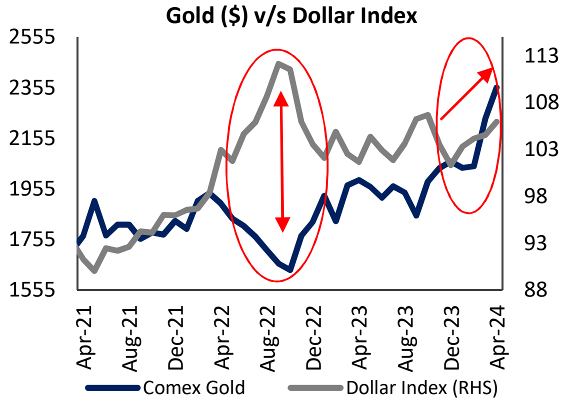
Central Bank's Bolstering Gold Reserves!!!

15th April, 2024

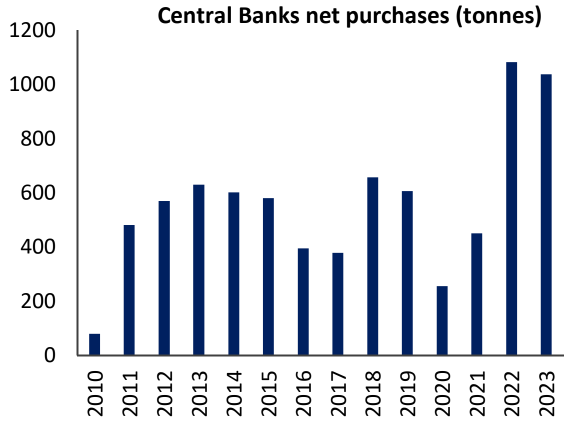
Gold continues to shine the brightest with a CAGR return of more than 10% in the last 5 years. There are multiple reasons that have been supportive for prices; from change in expectations of rate cuts by the Fed, black swan events like COVID, geo-political tensions .i.e. be it Russia-Ukraine or the most recent Iran-Israel, and increase in overall demand for safe haven assets primarily from central banks. Looking at the current scenario, we are in such an interesting phase, wherein all major economic correlations currently are out of sync. Recently, Dollar Index (DXY), Equities, Gold, Interest Rates, Yields are all inching higher, discounting future events and keeping market participants on the edge.



Source: Reuters

The Gold buying Spree

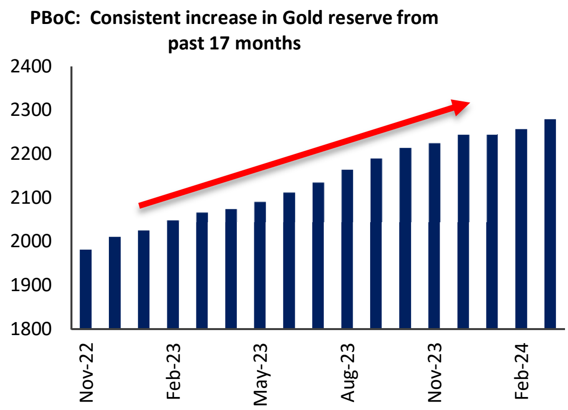
Central banks increase their gold reserves for several reasons like; Diversification (in various assets or away from Dollar), Safety and Security, Preservation of Wealth, Higher Credibility – increasing Prestige and Confidence, and Reserve Management.



Source: WGC

While investing, it is always good to follow 'buy low, sell high' strategy; however even with Gold trading at such high zone levels central banks led by China are increasing their gold reserves. China generally is a bargain hunter but here they are buying the top to fortify themselves against possible global monetary and financial blow up. Central Banks aren't in for a short term - they don't buy gold to trade; they are buying to hedge political risks, to underpin their own currencies and in place of US government bonds, which US is accumulating debt suggesting that they are no longer deemed to be risk free.

Last Quarterly report from WGC suggest that, Central bank demand, a key driver of gold in recent years, maintained its momentum in 2023 as well with total gold buying of 1037 tonnes, just short of the record set in 2022 of 1,082t. Global official sector gold reserves are now estimated to total 36,700t. Two successive years of over 1,000t of buying is testament to the recent strength in central bank demand for gold. Central banks have been consistent net buyers on an annual basis since 2010, accumulating over 7,800t in that time, of which more than a quarter was bought in the last two years.



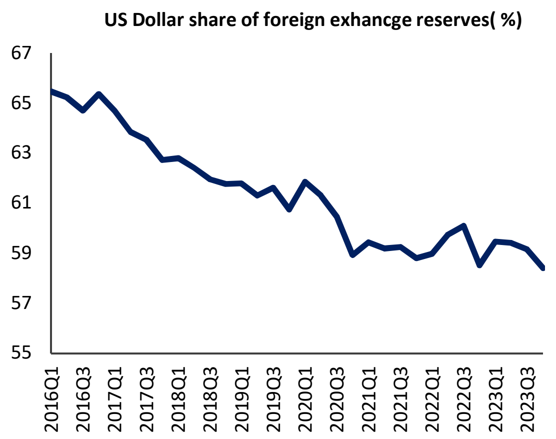
Source: WGC

China in the month of March marked 17th in a row that PBoC continued building golden blocks bringing their total to 72.74 mln ounces. Russia is also doubling its reserves of gold and foreign currencies on its de-dollarization path, further detaching Russia from the petrodollar empire as it reacts to wartime sanctions from the US and EU. Other countries like india, Turkey, Uzbekistan, Singapore, Iraq are also few other in the race of building Gold reserves.

Central banks buying Gold but selling Dollar?

Data from the IMF suggests that share of US dollars held by central banks as a percentage of their total foreign exchange reserves has declined over the years. According to IMF's Currency Composition of Official Foreign Exchange Reserves (COFER) data, share of US dollars in central bank foreign exchange reserves peaked at 72% in 2001, but in recent years have gone below 60%. Increasing demand for gold and other reserve assets could be one of the reason for this decline in US Dollar's share.

Just to take an example, over the years, Russia and China have been very active in terms of increasing their gold reserve. We have known historically that there have been lot of tiffs between these countries, hence it is also interesting to look at share of gold and Dollar's in its foreign exchange reserves. From 2016 to 2022, Russia's share of Dollar dropped from ~26% to ~21% and that of gold increased from ~17% to ~22%.

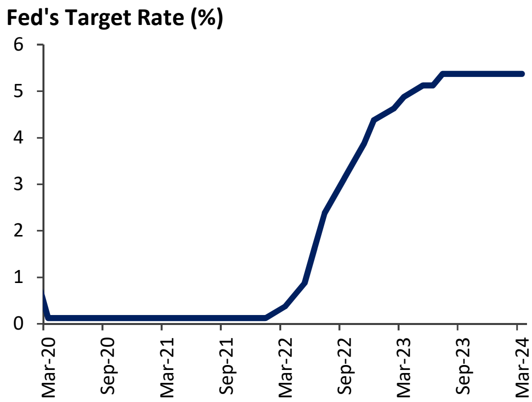


Source: IMF

Diversifying into other reserves along with Gold, as against to Dollar and protecting against the future geo-political threats could be one possible explanation. However, there is also one recent development that is important to focus on is the BRICS countries who have discussed the possibility of introducing a common currency backed by Gold, according to sources. Not only countries in the Middle East but also other nations, except South Africa, amongst BRICS are adding gold to their reserves.

Recent Market Updates:

Currently, market participants are sailing on multiple boats, out of which Fed's monetary policy action and development in the geo-political uncertainties are two most important factors to focus on currently. Fed since 2022 has raised rates by more than 1700 bps, reducing the overall liquidity from the market. Since past meetings, Fed has maintained a status quo w.r.t their interest rates, market participants are discounting three rate cuts in this year as per the latest dot plot released by the Fed.



Pandemic- Russia v/s Ukraine- Israel v/s Hamas- Iran & Israel - China & Taiwan, geo-political uncertainty every year continue to increase adding to the risk premium for Gold. Along with previous dispute still in place, fresh developments in other countries is raising the sense of panic in the market.

In the recent development, Iran and Iraq started a verbal quarrel which resulted in a drone attack on Israel. Anticipation of involvement of US in the matter also raised the heat, however we are yet to receive a word on any retaliation from Israel, which if happens could lead to further spike in precious metal prices.

Outlook:

We see that many central banks are buying gold and diversifying their portfolio, thereby reducing exposure to inter-market risks and volatility. This appreciation in gold reserve in the past decade by central banks amidst various issues, increased demand for the metal and is giving a boost to overall market sentiment. Gold price recently have seen sharp volatility amidst changes in inflation and interest rates expectations. It will be important to see how fed officials prepare the market from here and what kind of steps does the Fed take ahead. Economic numbers are being reported slightly mixed, if there is any sign of deterioration we could see further boost in the safe haven assets. We are not suggesting that central banks are directly selling dollar, the reason could be any, but it also cannot be ignored that Gold reserves is rising significantly. With increasing distress, uncertainties and sticky inflation, it becomes very important for central banks to keep their portfolio hedged. *It is advised to stay cautious at these levels, but our stance remain positive and we would suggest that any significant correction of ~5% could be used as a buying opportunity.*

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