CIO Viewpoint
Commodity

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Gold with potential, Oil stable and Lithium looking for the bottom

Key takeaways

- Gold prices recently received a tailwind from lower-than-expected inflation data from the U.S. and the repricing of Fed rate cuts on the swap markets.
- Oil price movements will largely be driven by developments in global growth and the production volumes of the OPEC+ countries.
- The "green" industrial metal lithium continues to offer a structurally positive outlook, but the market is currently still in an imbalance.

Gold prices should continue to benefit from the near-by Fed's interest rate turnaround

On July 26, the Olympic Games finally commenced in Paris. Although the gold content of the medals is limited to just 6 grams – they are mostly made of silver – the ultimate goal for the athletes will be to win a gold medal. As if it this had been arranged in advance, gold prices are now rising back to their record highs in the run-up to the Olympic Games. Gold prices struggled for a while in June. After reaching a record high of USD2,450/ounce, prices briefly slipped below the USD2,300/ounce mark twice before resuming their upward trend in July.

Furthermore, by the end of June, gold had already achieved double-digit price gains in almost all currencies since the beginning of the year. And then to cap it all, the gold price surged to a new record high of USD2,483.70/ounce in mid-July. At the beginning of August, the gold price missed this record high by a hair's breadth. Counter-intuitively, gold prices then did not benefit from the sharp decline in yields and the flight to "safe havens" such as the Swiss franc, but instead came under some pressure. The reason for this is likely to be losses of many market players in other markets, which were partly covered by sales of gold positions. But the outlook for gold in the medium term does not look weak.

a) Central Banks

Reports that the People's Bank of China (PBoC) had stopped buying gold for its currency reserves in May and June were partly responsible for the short-term setback in gold prices. Before that, the PBoC had been active as a buyer on the markets for 18 months without interruption. However, many other central banks continue to report continued buying interest. Many market observers presume that the Chinese central bank will also return to the markets to diversify its currency reserves as soon as gold prices fall moderately.

In 2023, central banks added 1,037 tonnes of gold – the second highest volume purchased in a single year – following the record high of 1,082 tonnes in 2022. Following these record numbers, gold continues to be viewed favourably by central banks as a reserve asset.

According to the 2024 Central Bank Gold Reserves (CBGR) survey conducted by the World Gold Council between February 19 and April 30, 2024 with a total of 70 respondents, 29% of central banks intend to increase their gold reserves in the next twelve months, which is the highest level recorded since the start of this survey in 2018.

Admittedly those who responded in February may not have had any idea that a gold price rally would begin in March. However, the motive to diversify reserves is likely to remain valid even at the current high price level.

In a continuation of a trend observed in last year's survey, the view of the USD's future proportion of total reserve assets has continued to decline, with 62% of respondents thinking that the dollar's share will decrease five years from now, up from 55% in 2023 and 42% in 2022.

Figure 1: Gold price (in USD per troy ounce)

Source: Bloomberg L.P., Deutsche Bank AG, Data as of August 7, 2024.

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When asked about gold's future share in global reserves, 69% of respondents thought that gold would occupy a higher proportion five years from now, up from 62% in 2023 and 46% in 2022. While 57% of advanced economy respondents think gold's share will rise, 75% of EMDE respondents believe it will do so. Nonetheless, it is notable too that the percentage of advanced economy respondents who believe that gold's share of global reserves will rise has increased significantly from 38% in 2023 to 57% in 2024. This year's Central Bank Gold Reserves Survey indicates continuing central bank interest in gold on the back of record levels of central bank gold buying. Geopolitical tensions and macroeconomic factors such as inflation and interest rates are front of mind for many central bank reserve managers.

b) ETF/ETC

While Asian buyers in particular have been very active as buyers on the markets since the beginning of the year, the gold price rally passed many investors in Europe and the U.S. by – unless they were already invested. This seems to have changed somewhat recently.

Following their strongest month since May 2023, global gold ETFs have now seen inflows for two months in a row; in June, notable European and Asian buying offset outflows from North America. Global physically backed gold ETFs attracted USD1.4bn in June. Inflows were widespread, with all regions seeing positive gains except for North America which experienced mild losses for a second month. In general, lower yields in key regions and non-dollar currency weaknesses boosted gold's allure for local investors. However, from January to April, both Europe and North America saw hefty outflows while Asia was the only region with inflows.

Year-to-date, global gold ETFs have lost USD6.7bn, their worst H1 since 2013. However, driven by recent inflows and a sizable rise in the gold price, their total AuM have increased by 8.8% YTD. Total holdings have dropped by 120t (-3.9%) to 3,105t since the start of the year. While Asian funds attracted a record USD3bn during the first half, they were significantly outpaced by collective outflows in North America and Europe to the tune of USD9.8bn.

It is worth mentioning that Western gold ETF investors did not react as anticipated to the rise in the gold price – which commonly drives up investment flows – amidst high interest rates and a more risk-on sentiment generated by the AI boom. By contrast, Asian flows followed the price strength – weaknesses in non-dollar currencies and gold's staggering performance in those currencies attracted investors in the region. Asia extended its inflow streak to 16 months in June.

Trading volumes across different gold markets witnessed a mild decline in June; however, the H1 average remains well above its 2023 level as OTC and futures trading were exceptionally active.

c) Competition for gold from interest rates returns is decreasing

During H1 bond yields generally moved sideways as Western central banks kept policy rates on hold. The Swiss National Bank, the ECB and the central banks of Sweden and Canada already lowered their key interest rates in Q2. The Bank of England started cutting rates on August 1. However, the elephant in the room for gold prices remains the market expectation regarding the monetary policy of the U.S. Federal Reserve.

Since the rate cut by the ECB in June, European gold ETFs have experienced inflows. A continuation of this trend would provide further support. And while there are already cuts by the Fed priced in by the market for later in the year, the actual policy decision would bring reassurance to investors about the direction of rates going forward, thus fostering sustained inflows.

On the flip side, of course, higher-for-longer may deter some gold investors from entering the market. However, following the release of U.S. June consumer and producer price data in July, expectations of Fed interest rate cuts in 2024 increased in the swap markets. It is true that gold prices have not yet been able to benefit sustainably from the crash in U.S. yields or the pricing-in of further key interest rate steps by the Fed on the swap markets at the beginning of August. However, if market activity returns to normal in the coming days and weeks, it is to be expected that this will change in favour of gold prices.

Opposing forces on the oil market

Since the start of the May oil prices have averaged around USD83/bbl, which is close to current levels. At the beginning of July, oil prices shot up to above USD87/bbl on the back of concerns regarding the impact on production of hurricane Beryl landing in Texas, the heartland of U.S. oil production that accounts for more than 40% of the nation's supply. However, early indications suggest the impact on output there was minimal as the hurricane weakened into a tropical storm, pulling oil prices back lower. In addition, geopolitics remain a source of uncertainty. Recently, we saw a genuine possibility of another front opening in the ongoing conflict in the Middle East, once again threatening to draw more regional players in the conflict. Although these concerns have since been outweighed by the economic uncertainty, they are unlikely to completely dissipate as the situation in the region remains fragile.

Figure 2: Brent oil price development over time (in USD per barrel)

Source: Bloomberg L.P. , Deutsche Bank AG, Data as of August 7, 2024.

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However, oil prices also suffered from the turbulence which shook the markets at the beginning of August due to fears of a U.S. recession that burgeoned following poor economic data. Brent prices fell to USD 75.05/barrel, their lowest level since January 2.

If market movements return to normal, various factors are likely to continue to suggest that oil prices will remain more or less in their trading range that has been well-defined since the beginning of the year.

The recent soft inflation prints in the U.S. and Fed Chair Powell's acknowledgement of an easing trend in price pressures have firmed up the expectations for impending rate cuts, supporting oil prices. On the other hand, the recent economic data out of China, the world's second largest oil consumer, has reinvigorated concerns surrounding China's ability to stimulate its economy and its oil appetite. Q2 2024 GDP growth slowed to 4.7% YoY whereas the refinery activity for June slowed by 3.7% YoY to 14.25mbbl/d. For H1 2024, refinery activity was largely flat, showing growth of just 0.4% YoY over the same period last year. In a similar vein, Chinese apparent oil demand fell to 13.7mbbl/d, its lowest since February of last year.

Similar offsetting effects of OPEC+ and non-OPEC+ supply

While the opposing forces of geopolitical, climatic, and economic factors continue to vie for dominance, similar offsetting forces are apparent when it comes to OPEC+ and non-OPEC+ supply. The underlying supply factors from OPEC+ remain largely unchanged since the last OPEC+ meeting. The group will start gradually phasing out 2.2mbbl/d of cuts from the beginning of the Q4 2024 until the end of Q3 2025. The remaining 3.66 mbbl/d of cuts will continue to remain in place at least until the end of next year. While the initial reaction to such a decision was largely bearish, we saw the constructive side of it. In our view, by starting to taper OPEC+ gave markets a clear picture for the next 18 months, which reduces uncertainty while at the same time by retaining the larger portion of the cuts intact it indicated that it is cognisant of the risks and will act if need be.

The IEA (International Energy Agency) expects demand growth to slow significantly this year with its latest estimate at close to 1mbbl/d for this year and the next, down from ca. 2.3mbbl/d in 2023. While it is a steep fall from the levels of last year, it is largely in-line with the average levels of the period 2011-2023. The real downside pressure on oil prices comes from the non-OPEC+ supply growth which is expected to increase by 1.5mbbl/d as per the agency's forecast, with the U.S. contributing a major share to this. It is pertinent to mention that according to the Energy Information Administration EIA (U.S. government department) weekly supply data, U.S. oil production has so far struggled to climb significantly higher with the latest datapoint only 100kbbl/d higher than the level at the start of the year. We acknowledge that there is room for the IEA non-OPEC+ supply growth forecast to be too high, which would be positive for the oil prices.

Even if this does not come to pass, the above-mentioned cuts by OPEC+ so far this year and its guidance for the future (provided countries produce in line with their quotas) will result in estimated global oil supply of growth of 770kbbl/d. supply growth is therefore, unlikely to surpass demand growth this year.

Excursus - Lithium: Searching for the price floor

With a price close to a three-year low of just under USD13,000/t, the lithium carbonate price has been at a low level for some time. Prices have fallen by around 80% since 2022. Some analysts even believe that the bottom has not yet been reached and do not expect this to occur until 2027.

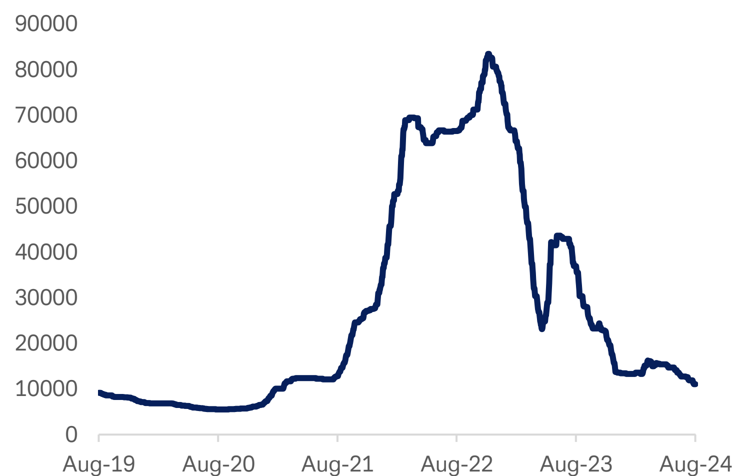
The reasons for the price drop are the opposing developments on the supply and demand sides. Forecasts for 2025 indicate an increase in supply of around 30%. This is significantly higher than the expected demand growth of around 23%. The latter may be surprising, as the metal is expected to play a major role in the energy transition. The sluggish demand is due to the situation in the electric vehicle (EV) sector. Consumers in the U.S. and Europe are postponing major purchases. The discontinuation of subsidies is also a factor. In addition, concerns about the (charging) infrastructure are also weighing on sales in some regions.

In China, consumer demand remains subdued, primarily due to the ongoing problems in the property market. The penetration of EVs in the Middle Kingdom is already significantly greater than in many other automotive markets, both on the demand and the supply side, which is why purchasing restraint there is having a strong impact. The introduction of tariffs on Chinese suppliers of batteries or EVs by the U.S. and, most recently, also in the EU is likely to have a negative impact on lithium demand.

In this environment, the question on the supply side is whether mine operators will reduce their production accordingly to support prices – similar to OPEC+.

Some smaller mining companies have already cut back their production due to rising costs. The current reporting season should provide new insights into whether major producers are also beginning to cut back production or to postpone plans to develop new deposits.

Figure 3: Price development of lithium carbonate (China Lithiumcarbonat 99.5%, in USD/t)



Source: Bloomberg L.P., Deutsche Bank AG. Data as of August 7, 2024.

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The prices for spodumene, one of the most important raw materials for extracting lithium, fell to a level at which mine operators had recently reduced their output. Some producers in China have already reported a net loss for the first half of the year. However, many mine operators have so far been reluctant to reduce their production. The reasons for this range from retaining scarce skilled workers, avoiding start-up costs when production is to increased again , to reliability in terms of being able to delivery materials to customers without disruptions. This could delay the necessary adjustment of supply. Some market observers therefore expect the supply surplus in the market to lead to an imbalance between supply and demand until 2027.

Although the outlook for demand is currently clouded by the lower sales of EVs, lithium is likely to see higher demand in the medium term. The storage of electricity via lithium batteries is not limited to mobility, but is also increasingly being used in energy production where the decline in the price of lithium is significantly reducing the costs of battery production and is likely to boost demand in the medium term.

The increased use of renewable energies (especially wind and solar energy) in electricity generation often means that the sun is shining and the wind is blowing, generating a lot of electricity, but that at the same time demand for electricity is maybe low. Demand for energy storage solutions is therefore growing. Large-scale lithium-ion storage batteries are therefore being used in increasing numbers. In Germany, the market for storage technology is still in the development phase, with a volume of around EUR16bn, but annual growth between 2022 and 2023 was already almost 50%

According to data from the International Energy Agency, demand for electricity will continue to increase, thus boosting demand for lithium. According to estimates by the Energy Agency, for example, global demand for electricity is expected to grow by around 4% in 2024, the highest percentage increase since 2007. At the same time, demand for clean energy sources is also rising. By 2025, the amount of energy generated worldwide from renewable sources could exceed the amount of energy generated from coal. In 2023, the share of renewable energies in electricity production was already around 30%.

In addition to increasing electrification due to the shift away from fossil fuels, the demand for cooling systems and the increase in power-hungry data centres as a result of the expansion of AI, as well as global economic growth, are all contributing to the steady growth in energy demand. In the long term, the demand for lithium could therefore increase again. However, investors should be patient and wait until the price of the metal has bottomed out, given the current imbalance between supply and demand.

Conclusion

Regarding Gold, some arguments support a continued rise in gold prices. Central banks will probably continue to buy gold for diversification purposes. This should at the very least put some floor under prices, even if price-sensitive central banks like China's are currently hesitant to return to the market. In addition, previous gold highs have coincided with strong Western flows suggesting that the gold market is not yet saturated. Buying interest from Asian demand should remain at a high level. And geopolitical risks may not currently be adequately priced into the financial markets. This suggests further potential for gold prices, so we are currently maintaining our price target of USD2,600/ounce for the end of June 2025.

On the oil market there are opposing forces at play. The efforts by OPEC+ are being offset by non-OPEC+ supply, keeping oil prices roughly in the range of USD75-85/bbl recently. The supply/demand outlook for 2025 remains much foggier for the time being. While current estimates suggest supply outpacing demand in the coming year as some of the OPEC+ output is factored to come back, prices are unlikely to materially sell off as market participants will continue to factor in the “OPEC+ put”. In addition, our forecasts suggest a recovery was already taking shape in U.S. with economic growth by the end of the H1 2024, likely encouraging buying sentiment. Brent is therefore expected to fluctuate around the central tendency of USD80/bbl.

The "green" industrial metal lithium continues to offer a structurally positive outlook, but the market is currently still in an imbalance. While demand is facing challenges due to the weaker economy, the supply side is still cautious with production cuts. If this imbalance is reduced in the coming quarters and the price has found its bottom, this could well present entry opportunities for investors. The long-term perspective is likely to become increasingly important in the coming years.

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Glossary

EMDE means EMerging and DEveloping countries .

Exchange-traded commodities (ETC) are securities traded on the stock exchange that allow investors to invest in the commodity asset class.

Exchange Traded Funds (ETFs) are investment funds traded on stock exchanges.

Futures are standardized contract in which a buyer and seller agree to deliver or take delivery of a specific amount of an underlying asset at maturity at a fixed price.

The International Energy Agency (IEA) is a cooperation platform in the field of research, development, market introduction and application of energy technologies.

Lithium carbonate is the lithium salt of carbonic acid. Lithium carbonate is the most important lithium compound.

OPEC-plus (also: OPEC+) is a group of oil exporting countries. It is a cooperation of the currently 13 OPEC member states with the currently 10 cooperating partners, the so-called non-OPEC oil producing countries.

OTC (Over-the-Counter refers to trading that is not carried out on a traditional stock exchange.

People's Bank of China (PBoC) is the central bank of the people's republic of China.

Spodumene has a theoretical Li2O content of 8.03%. Due to its high lithium content, spodumene is considered the most important lithium ore mineral.

The renminbi (RMB) is the official currency of the People's Republic of China.

USD is the currency code for the U.S. Dollar.

The World Gold Council is a global lobby organization for the gold mining industry.

YoY – Year over year

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Historical performance

Performance	12.8.2019 - 12.8.2020	12.8.2020 - 12.8.2021	12.8.2021 - 12.8.2022	12.8.2022 - 12.8.2023	12.8.2023 - 12.8.2024
Brent	-22.4%	57.0%	37.6%	-11.6%	-5.2%
WTI	-22.3%	61.9%	33.3%	-9.7%	-3.8%
Gold	26.8%	-8.5%	2.8%	6.2%	29.2%
China Lithium Carbonat 99.5%	-39.7%	148.1%	387.2%	-46.7%	-69.9%

Source: Bloomberg L.P., Deutsche Bank AG. Data as of August 12, 2024.

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