For wholesale and professional investors only

Monthly Commentary

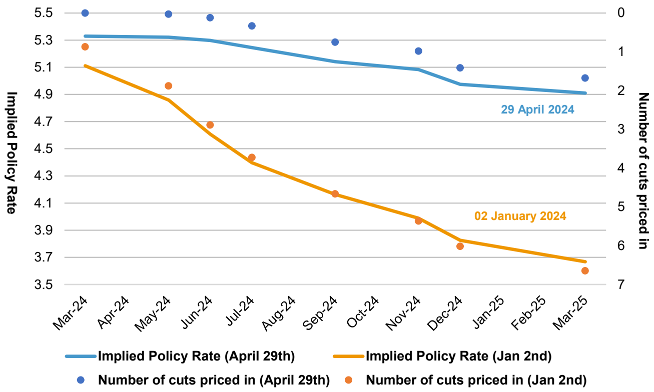
April 2024

Welcome to our new format for monthly commentaries. We bring you a selection of charts that have caught our eye and that capture the significant economic and market developments over the month.

Rate repricing

The dominant story in April has been the continued repricing of interest rate expectations in the US. It was clear to us and many others that the market reaction following Powell's presser at the end of December last year was overdone. As we entered the year the market was forecasting 6 rate cuts in 2024 leaving the base rate at around 3.8%. That has since corrected sharply with current consensus around 2 cuts (5.1% base rate at the end of the year) and a more than 0% probability of a hike.

Fed Funds Futures



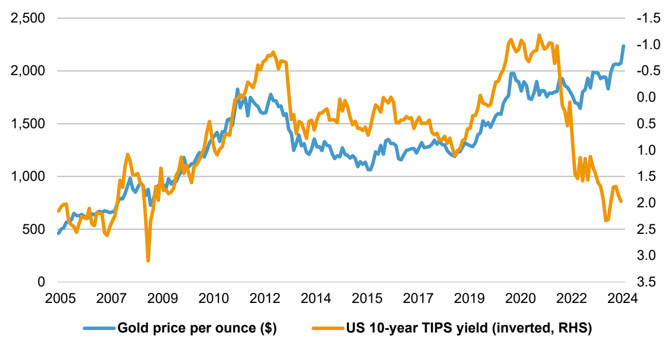
Source: Refinitiv/Datastream

Current pricing is certainly a better reflection of resilient growth in the US (Q1 GDP came in below consensus at 1.6%) and sticky inflation driven by services CPI which ticked up from 4.95% in Feb to 5.27% in March. It has also given strength to the dollar which has rippled through Asian FX pairs in particular. The Yen has now depreciated by 18.5% over the last year followed by the Indonesian Rupiah (-9.3%), Thai Baht (-8.3%), Malaysian Ringgit (-7%) and Chinese Yuan (-4.6%).

Gold escaping higher real yields

Investors have long bought gold as a way of protecting themselves against the risk of a rise in inflation. Gold tends to benefit from a decline in real rates – borrowing costs adjusted for inflation. Over the long term, gold has played a role in protecting against the effects of inflation as gold provides an alternative store of value when yields are low or negative though it offers no yield.

Gold vs US 10-year TIPS yield



Source: Refinitiv/Datastream

If this relationship holds and real yields are moving higher, the gold price should be trending lower not hitting record highs. One possible reason for the recent breakout in gold is central bank buying which has grown from 10% to 20% of total global demand since 2022. Whilst developed markets gradually sold down reserves prior to the GFC, emerging market central banks have been buying given the metals performance through the GFC, COVID and when Russia invaded Ukraine.

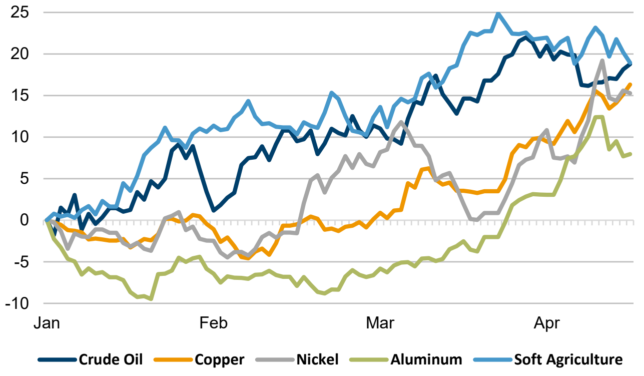
Of course, the desire to diversify away from the US financial system for some countries is clear. China and Russia have both ramped up their gold piles to distance themselves from the reach of the US. In selling down treasury reserves to buy gold, treasury yields may be pushed higher.

Another reason could simply be that inflation expectations are too low i.e. the real yield should be lower. As mentioned earlier in this piece, with recent inflation prints proving to be sticky, there is clearly still work to be done in achieving central bank inflation targets and expectations have repriced accordingly.

Commodity upswing

Gold has been joined by the wider commodity complex, climbing in the face of dollar strength. Historically, there's been a loose negative relationship between the USD and commodities. Given that most commodities are priced in dollars, when the dollar gets expensive, demand for commodities should in theory fall. That relationship has flipped the other way since 2021, causing a double dose of pain particularly for commodity importers.

Commodities - % increase year to date



Source: Refinitiv/Datastream

The chart above shows the increase in oil, industrial metals and soft agriculture prices (which include cocoa, cotton, sugar and coffee) year to date. The dollar index has climbed by around 5% over the same period. The broad increase in commodity prices is bound to filter through to producer prices and then CPI, causing further headaches for central bankers. Whilst each has its own story, structural drivers for commodity appreciation are falling into place. Generally prices are being supported by a fragile supply environment due to chronic underinvestment (oil and copper), climate change (softs) and/or geopolitics (oil and gold). Meanwhile demand for energy and industrial metals in particular have a number of structural drivers including but not limited to the energy transition, higher defence budgets and AI related investment.

Pyrford International
30 April 2024

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