

Gold caught between surging bond yields and rising fiscal concerns

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Key Points:

- Macro headwinds intensify: In the last month, a 3% dollar rally and a 50-basis-point surge in US Treasury yields have pressured gold, pushing real yields towards 3%.
- ETF demand defies falling prices: Gold ETF holdings have climbed to a four-year high, highlighting the divide between short-term traders and strategic investors.
- Rising yields fuel fiscal concerns: Higher borrowing costs increase debt-servicing pressures, potentially strengthening gold's appeal as protection against sovereign debt risks.
- Gold's resilience faces further tests: Near-term downside risks persist, but continued investment demand could support a recovery once the dollar and real yields stabilise.

Gold continues to attract buyers despite facing some of its strongest macroeconomic headwinds in years. Over the past month, a sharp rebound in the dollar, surging government bond yields and a corresponding rise in real yields have increased the opportunity cost of holding the non-yielding metal. Yet, while short-term traders have responded by reducing exposure, longer-term investors continue to accumulate gold, seemingly looking beyond immediate macroeconomic pressures towards the potential fiscal consequences of persistently high borrowing costs.

The contrasting behaviour has created an increasingly visible battle between macro- and technically focused traders selling into weakness and strategic investors using lower prices to increase exposure. The latter appears particularly concerned about rising government debt, deteriorating fiscal positions and the risk that higher borrowing costs will eventually undermine economic stability and confidence in sovereign debt.

A powerful combination of macroeconomic headwinds

The scale of the recent headwinds is considerable. Over the past month, the Bloomberg Dollar Spot Index has risen by more than 3%, supported by broad-based gains against major currencies, particularly the euro, yen and several commodity-linked currencies. Gold, meanwhile, has fallen by around 5%, meaning that the stronger dollar has accounted for more than half the decline in XAUUSD when measured against the currency basket.

This highlights an important distinction: while dollar-denominated gold has suffered, the decline has been considerably less pronounced for investors measuring returns in other currencies.

At the same time, the US Treasury market has experienced a sharp selloff, with yields across the curve rising substantially. The five- and ten-year yields have climbed by around 50 basis points over the past month, with the ten-year reaching approximately 5.3%, while the 30-year has approached 5.7%. These are levels not seen in decades, highlighting growing pressure on bond markets as investors reassess inflation, monetary policy and fiscal risks.

Perhaps most importantly for gold, the US ten-year real yield has risen by approximately 50 basis points towards 3%, significantly increasing the opportunity cost of holding an asset that offers no interest income. Against this backdrop, gold's resilience is noteworthy. Following a brief break below USD 4,100 on Thursday, as bond yields and the dollar reached fresh cycle highs, prices have recovered above that level. The price action suggests that while sellers remain active, underlying demand continues to emerge on weakness.

ETF demand tells a different story

The clearest evidence of this underlying demand comes from gold-backed exchange-traded funds. Despite the recent correction, total ETF holdings have continued to rise, reaching a fresh four-year high of 3,149 tonnes on Wednesday, an increase of 72 tonnes since the beginning of September.

The divergence is striking. While gold prices have fallen, ETF investors have continued accumulating metal, suggesting that a meaningful part of demand is either relatively insensitive to interest rates or increasingly concerned about the longer-term implications of rising government borrowing costs.

This contrasts with the behaviour of leveraged and shorter-term traders, whose positioning tends to be more sensitive to changes in yields, currencies and technical price signals. For these participants, higher real yields and a stronger dollar provide compelling reasons to reduce exposure, particularly when key support levels are challenged.

For longer-term investors, however, the calculation may be different. Gold's lack of yield is a disadvantage when interest rates rise, but its absence of sovereign credit risk becomes increasingly attractive when confidence in government finances begins to weaken.

Traditionally, higher real yields are negative for gold because they increase the relative attraction of interest-bearing assets. That relationship remains relevant, as demonstrated by the recent correction. However, the underlying reason for rising yields matters.

When yields rise because of stronger economic growth or expectations of tighter monetary policy, the implications for gold are generally negative. But when yields rise because investors demand greater compensation for fiscal uncertainty, persistent inflation or growing government borrowing requirements, the relationship becomes more complicated.

Higher borrowing costs increase the cost of servicing existing debt as it matures and must be refinanced, potentially worsening fiscal deficits and creating additional borrowing requirements. This can produce a negative feedback loop, particularly for heavily indebted governments already struggling to contain spending.

For investors concerned about this development, gold offers diversification away from sovereign debt and currencies whose long-term purchasing power may ultimately be affected by fiscal and monetary policy responses.

In other words, the same rise in yields that discourages short-term gold ownership may also strengthen the longer-term case for holding it. This does not eliminate the risk of further price declines, but it may help explain why investment demand remains resilient despite the increasingly challenging macroeconomic environment.

China and the preference for gold over silver

The return of Chinese investors following the week-long Golden Week holiday may also have contributed to Thursday's recovery. Chinese investment demand, together with continued central bank diversification, represents another source of buying that may be less directly influenced by changes in US interest rates. Importantly, the opportunity cost of holding non-yielding gold is considerably lower in China, where one-year government bonds yield around 1.2% in yuan, compared with almost 4.5% for comparable US dollar-denominated Treasuries. In addition to a general weak domestic economy and properties no longer being the preferred investment choice, this substantial interest-rate differential may help explain why Chinese demand remains relatively resilient despite rising US yields.

Meanwhile, gold's relative strength compared with silver provides another indication of investors' defensive preferences. The gold-silver ratio has risen above 70, a two-month high, while ETF flows suggest investors currently favour gold over silver.

Unlike gold, silver has substantial industrial exposure, making it more vulnerable to concerns about slowing economic activity and tightening financial conditions. This may explain why investors seeking protection against fiscal and monetary uncertainty are currently favouring gold's more defensive characteristics.

Outlook: The battle is far from over

In the near term, gold remains vulnerable to further dollar strength, rising real yields and technically driven selling. A sustained break below USD 4,100 would risk renewed pressure towards the psychologically important USD 4,000 level.

However, the continued accumulation of gold through ETFs suggests that the correction has not fundamentally undermined longer-term investment demand.

The key question is what happens when the current macroeconomic headwinds eventually stabilise or reverse. If gold can retain strategic buyers while real yields approach 3% and the dollar continues to strengthen, a subsequent easing in either could provide renewed support, particularly if speculative investors begin rebuilding exposure.

For now, gold remains caught between two competing forces: traders responding to the immediate cost of holding a non-yielding asset and investors increasingly concerned about the longer-term consequences of rising debt and borrowing costs.

The most revealing development may be that gold is increasingly attracting buyers not despite rising government bond yields, but partly because of what those yields may signal.

Using trend signals based on the relationship between selected daily moving averages (DMA), we find they currently point to a bearish trend across all three time horizons for both gold and silver. The signals are defined as follows:

A bullish signal occurs when the shorter moving average trades above the longer one, while a bearish signal occurs when it trades below.

Gold: All three signals currently point lower, with the short-term trend having recently turned bearish as the 10 DMA crossed below the 100 DMA. The medium- and long-term signals have maintained a negative bias since June, reflecting the broader correction from earlier highs.

Silver: The technical picture is similarly weak, with the 10 DMA trading below the 100 DMA, while both

the 20 DMA and 50 DMA remain below the 200 DMA. This confirms a bearish trend across all three time horizons.

Importantly, these signals are not recommendations to buy or sell. They simply provide an objective, backward-looking assessment of prevailing price trends based on the relative positioning of key moving averages. As lagging indicators, they may remain bearish even after prices have begun to recover.

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