

Research @ Citi Podcast, Episode 79: What's Next for the Trillion Dollar Gold Trade?

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Transcript:

Elise Badoy (00:00)

Welcome to the Research @ Citi podcast. I'm your host, Elise Badoy, Head of UK, Europe, Middle East and Africa Equity Research at Citi. I'm here recording in London and delighted to be joined today by Max Layton, Head of Commodities Research at Citi.

In this episode, we're going to talk about gold, and I'm going to start off right away with a question on gold pricing dynamics. Our listeners may have listened to previous podcasts on gold with Max, but it's always good to remember there are so many different models for gold pricing out there. Max, what in your experience is the best way to think about gold?

Max Layton (00:37)

Thanks, Elise. Hi everyone. So I've worked at a number of different banks and they've all used different models — or I'd more accurately call them *correlations*. And these correlations, whether it's real rates or currency models, they work sometimes and they don't work other times.

What we've found over the last couple of years — and we've published a lot on it — is that gold pricing quarterly over the last 15 years and annually over the last 50 years can be explained near fully by a traditional commodity supply-demand balance. The most important part of that supply-demand balance is demand. It's the most volatile part, and it ultimately is driven by how much people want to allocate to gold — how much dollar allocation, dollar capital allocation, there is to gold.

It's the most volatile factor in the gold supply-demand balance, and it's the most important factor. So demand can go up relative to mine supply and scrap supply — both of them are pretty inelastic. When that happens, the price needs to find the marginal stockholder to sell. And typically, in gold, they don't want to sell when the price is going up and when demand is going up. So you can have these amazing bull markets in gold.

In other words, the price is determined in gold largely by dollar capital allocation to physical gold, and then you divide that by supply — mine supply, scrap, stock sales — which is pretty finite and relatively not very volatile. And this framework, as I mentioned, it's worked for a very long time and it doesn't really break down like those other currency models or real rates models.

Elise Badoy (02:12)

And so I'm Head of Equity Research, Max, and gold is really trading like a risk asset of late. It's fallen more than 10% since the Iran conflict started. What is going on with that? Does your framework help explain it?

Max Layton (02:25)

In many ways, it's surprising that gold has sold off considering the oil supply shock that's going on. I think the most important thing to note is that the rally preceding the sell-off had been particularly spectacular. You had the gold price going up over the prior three years from \$2,000 to \$5,500. So in that context, the pullback to where we are today — to around \$4,700, a bit over a 10% pullback — it takes you to still the highest levels that we've seen, certainly relative to mining costs of production, in 50 to 55 years. So it's still a super high price.

But what was going on with that pullback? I mean, first I mentioned that it's obviously been a spectacular performer up until then. The driver of that performance was predominantly investor demand. And that investor demand had driven total spend on gold from \$300 to \$400 billion over the last, say, five to 15 years — that's like the normal spend on gold — all the way up to a trillion dollars pre the Iran conflict. So it had gone even over a trillion dollars on our estimates. The world was allocating a massive amount to gold, and that's slightly come down since the Iran conflict.

Essentially, the investors that were investing in gold over the last 12 to 18 months have taken a little bit of profit off the table, and that has created or contributed to a lot of the volatility that we've seen over the last month or two. There was a lot of momentum buying, a lot of retail buying, and some of that has come out of the market.

Elise Badoy (04:07)

Max, you've alluded to it, but how do you think about the situation in Iran and its impact on gold specifically? Obviously, a lot of the focus is rightfully on the oil price. What's your near-term outlook for the gold price?

Max Layton (04:21)

Near-term we're cautious on gold. We think that it will fall, in our base-case scenario, down to around \$4,300 an ounce over the next three months. And that is largely driven by our concern about a potential broader risk-asset sell-off related to higher oil prices, which is related to the closure of the Strait of Hormuz.

We're bullish on oil. We think oil will continue to rise over the next couple of months. Essentially, the Iranian regime has substantial if not full control of the Strait of Hormuz, and we think that they're incentivized, for as long as they can, to keep that strait closed. They're incentivized to do that to maximize deterrence, also to maximize the present value of future oil revenue. And for these reasons, we're quite concerned that they continue to drive up the oil price and that that leads to a broader risk-off event — which, if you go back over the last 30 years, major risk-offs have seen gold go lower, at least initially.

In many ways, it feels to us, or to me, like March and April of 2022. The Russia-Ukraine energy shock was unfolding. Energy prices were rallying. Metals were rallying. Ags were rallying. Gold went up. Equities were super resilient and many of them went up. It feels like that at the moment. And then May of 2022 came along and everything moved lower for much of the rest of 2022.

Now, I'm not saying everything is going to move lower — I don't want to make a big call about other risk assets — but there's certainly that risk that people re-evaluate their growth expectations and that we have a bit of a risk-off and gold goes with that, temporarily at least.

Elise Badoy (06:12)

So I think the key question is, therefore, Do you think gold is more susceptible to volatility now than before?

Max Layton (06:20)

I certainly believe it is. We've got a trillion dollars of allocation on an ongoing basis to physical gold. Small shifts up or down — or potentially big shifts up or down — in that allocation can result in really big moves in the gold price. I mean, ultimately, gold's worth what people are willing to allocate to it, as I mentioned, relative to that finite supply. In a way, that's quite similar to Bitcoin, and we've seen how volatile Bitcoin can be.

Not only can we think about it from those angles, but there are also the stockholders of gold. There's a massive stockpile of gold that has gone up in value dramatically over the last three to four years, and the people who own that gold may hedge some of their position or reallocate a little bit away from gold, especially if it's not really performing alongside other asset classes, maybe like equities. So it's very susceptible — kind of like Bitcoin — to old stockholders selling, because the value of that above-ground gold stock dwarfs the flow market.

So I mentioned that trillion dollars. The value of above-ground gold stocks is over \$30 trillion dollars compared to the \$1 trillion value flow market. So, a tiny amount of reallocation, or hedging, or selling of that above-ground gold stock, and you can obviously see massive volatility in the gold price.

Elise Badoy (07:43)

I see. And so the stockholders of gold, they are sitting on massive profits obviously. Do you want to expand a little bit on that? Because there's also the question of portfolio rebalancing.

Max Layton (07:57)

The total above-ground stocks were worth about \$15 trillion at the end of 2023, so a bit over two years ago, and the total value now is about \$32 trillion. So there's \$17 trillion of profits. About \$3 to \$4 trillion of that is central bank and the rest is investors: ultra-high-net-worth, jewelry holders, retail bar and coin, these kinds of markets. There are no real signs of any stockholder liquidation on the ultra-high-net-worth side — or maybe there's some small retail profit-taking. But generally speaking, the bulk of those holders have been pretty sticky to this point.

Elise Badoy (08:38)

And what about central banks?

Max Layton (08:41)

Yeah, there's been a lot of headlines about the selling from Turkey. I've got to say my best guess is that some other significant players bought up those tons, because the tonnages reportedly sold by Turkey were so big you might think that would have had an even bigger impact on the gold market than it did. So I think some other substantial players have probably picked that up.

So a bit of selling by Turkey, probably some buying from others. Otherwise, the big buyers over recent years have been China and Poland, and they keep buying. So pretty sticky buying from the central banks. Stockholders aren't really showing any signs of selling, and on that note, I don't think there's any major producer hedging either.

Elise Badoy (09:23)

Obviously, when you have such a pool of profit, governments need money, and so it's going to attract interest. We've noticed in particular that India has recently raised taxes on gold, the currency is depreciating, while China is opening up for gold purchases. How would this impact gold?

Max Layton (09:41)

So there have been some offsetting dynamics that have been going on when you look at two of the biggest gold demand markets in the world, China and India.

Chinese demand has gone up substantially. Certainly, the dollar spend on gold over the last quarter has gone up dramatically — the value of imports are up, running annualized in March at about \$300 billion, which is just massive, absolutely massive, a big chunk of that trillion in the global total. At the same time, India has really, really, stepped back. I mean, India was buying all through last year, buying the highs, which was super unusual — largely jewelry of course, but also a little bit of ETF, and bar and coin. And they've just completely stepped back from the market. Prime Minister Modi has requested that people do that to help protect the balance of payments.

We expect both of those trends are going to continue, in the sense that we think Chinese demand will remain very strong and India will remain stepping back from the market. And the scale of both moves — the deltas over the last couple of months — has been roughly offsetting. So that's part of the reason why China hasn't driven the gold price up and India hasn't driven it down — it's because they're largely offsetting each other.

Elise Badoy (10:57)

Listeners and investors all have the same question, which is when does the Strait of Hormuz open again? When do we have a deal? We are not going to try to answer that question actually for this, but I'd love to understand the scenario in your head, in terms of if there's a quick deal, how does it trade? And if there's a very prolonged closure, on the other hand, how does that work? Do you want to contrast the two outcomes, Max?

Max Layton (11:21)

So look, I think if there's a quick deal, risk will move higher and gold has been trading in line with risk, and I think you'll have people come back into gold because the medium-term structural stories are all still in place, and the fear of a liquidation event will go down, and I think people will put the gold trade back on and we'll be back above \$5K very quickly if there's a quick deal.

If there's a prolonged closure, that's an extension of our base-case caution in the near term, so I'd expect the weakness to go on for a bit longer. But then if this prolonged closure eventually results in a kind of stagflationary world, things like gold will join oil and agricultural commodities as being the safe-haven assets to buy, post the risk-off. So medium-term, the prolonged closure scenario is probably very bullish gold.

I just want to make the point that during the late 1970s, the Fed was moderately to very behind the curve and you had falling real rates. And during that period during the second oil shock, gold did extremely well. So it's also important, when you're thinking about gold price action in a stagflationary world or in a prolonged Hormuz closure world, to think about how the Fed is going to react. Because if the Fed remains moderately to very behind the curve, it's going to be a super bullish environment for gold. But if there's a Volcker moment? I mean, after Volcker raised rates

and dramatically raised real interest rates in the U.S., gold did come down. Metals came down more broadly and you had a pretty broad, big sell-off. So I think it's really important to be tracking how the Fed is behaving as well.

Elise Badoy (13:10)

You've just said that you are bullish medium-term on gold. Can you just detail the case here? What makes you bullish medium-term?

Max Layton (13:19)

The structural factors are still in place. China is running a big trade surplus and in many ways it's running out of places to invest outside of China. And therefore there's this increasing likelihood that, from a national perspective, there's a sustained strong allocation to gold. The second part is within China, they have excess savings and there's a relative lack of investment options. So that helps to explain the strong retail buying that we've seen recently and over the last few years in China. And that's something that's going to continue. So the China angle looks pretty bullish medium-term, or at least supportive of super-high prices.

Then you've got the whole geopolitical divide between, let's say, China, Russia, Iran, and many of the OECD countries, and the risks that are associated with that divergence. So people may want to continue to allocate to gold as a hedge against those geopolitical risks materializing.

And then government debt is the other big one, right? Like, government debt is not getting any better. Many governments globally are taking this oil shock onto their balance sheet to try to protect consumers, and that's worsening the situation. Government debt, well, it isn't such a big problem when interest rates are zero, but if interest rates are relatively high and potentially rising because of the Strait of Hormuz energy shock, then obviously government balance sheets are deteriorating even more. So the temptation to run the economy hot is even greater, and the risk of recession is even greater. So I think the medium-term allocation for gold part of your portfolio makes even more sense in that world.

And then, finally, there are still big long-term concerns about the impact of AI on society and a potential AI-led equity bubble. I mean, these things are still concerning people, and one of the ways to hedge against the implications of those concerns is to have a gold allocation.

Elise Badoy (15:21)

Max, are there any other areas where you see value for investors?

Max Layton (15:26)

There sure are, yeah. We really like near-dated oil exposure that earns the roll yield from the backwardation, which is related to the low inventories that we see in oil as a result of the recent and ongoing Strait of Hormuz closure. We like that as a hedge against a much longer, more prolonged issue in the Strait of Hormuz.

The other things we're really bullish on are agricultural commodities — particularly as a hedge against the prolonged Strait of Hormuz closure, but also because of the El Niño weather event, which is very likely to occur. It's just a matter of how bad the El Niño event will be. We're especially bullish on cocoa, sugar, Robusta coffee — and so essentially chocolate and instant coffee. Really bullish over the next three to six months, and even beyond that, over the next 12

to 18 months as well, because a lot of these crops are going to potentially be affected for quite some time.

I just wanted to highlight that oil is used to protect crops from disease, it's used to make fertilizer to maximize yields, oil is used to harvest and transport crops. And, you know, some crops are used as substitutes for oil as biofuels — like sugar and corn — and all of this means that the Strait of Hormuz closure can be bullish not just in a normal, kind of linear way, but in a convex way for agricultural commodities. So we actually opened a trade recommendation that was bullish on agricultural commodities recently.

And finally, we're really bullish on the aluminium medium-term outlook. There's no spare capacity in this market. It's being hit by the biggest supply shock in the history of its market. It has extremely low inventories — around 50-year low inventories coming into this shock. And the substitutes for aluminium, like plastics and copper, are very expensive. So, the supply-side setup in particular in aluminium is as bullish as I can remember it.

Elise Badoy (17:19)

Max, thanks very much for those views.

This episode of Research @ Citi was recorded on Thursday, May 14, 2026. I'm your host, Elise Badoy. If you enjoyed today's conversation, be sure to follow or subscribe so you don't miss what's coming next. We've got more great insights and discussions on the way. See you next time.

Disclaimer (17:40)

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