Gold Bug Glee

- 'Conventional' drivers of gold are coming together
- The Fed's plans are a source of uncertainty
- A precursor to something of long-term significance?

Gold can tap support from various pools; and in 2019, many are coming together as one.

The global economic backdrop is hardly a fertile environment for a "traditional" hedge against inflation like gold. Then again, since the turn of the millennium, or indeed 1970, the correlation between annual US inflation and the price of gold has been negative.

Similarly, although the price of yield-free gold is rising in an era of low interest rates, the long-term relationship between the two is weak.

And with the USD Index currently 1.0% higher than where it stood at the start of the year, gold’s $139 rally year-to-date can hardly be pinned on its oft-touted inverse relationship with the currency.

The point is, however, that although some of these drivers of gold have been far from dependable, some are coming together right now to the undoubted delight of the ‘bugs’.

The potential for instability in
the highly inflated prices of more productive assets lends itself to broad-based buying of gold by way of insurance

Although sometimes confined to the initial stages of the dispute in question, geopolitical tensions have a track record of boosting demand for the metal; and whether it be ongoing tensions in the Gulf or the protracted uncertainty stemming from various trade disputes, there is certainly fuel on this front to keep gold supported at least.

Of course, the Fed’s designs on US monetary policy are a source of uncertainty for the gold market, but a blinkered focus on the USD and Fed belies what has been a steady inflation of prices relative to the world’s major currencies since the start of last month, as the accompanying chart highlights.

Indeed, although the bond/equity relationship has gyrated over time, that gold has accompanied rallies in both asset classes in recent weeks is largely a reflection upon some startling revelations about the health of the global economy.

In itself, the potential for instability in the highly inflated prices of more productive assets lends itself to broad-based buying of gold by way of insurance; but a sudden deterioration in global economic prospects has simply upped the ante and preempted a further suppression of interest rates across the globe in anticipation of the collective deployment of central bank ‘puts’.

3. Aussie unemployment rate unchanged in June amid part-time job slump

4. Bank of Korea surprises with first rate cut in three years

5. US-Japan trade talks being worked on "pretty hard" says Japan’s G20 sherpa

On the Radar

July 18, 2019

- UK June retail sales (0930 GMT+1)
- US Jul Philly Fed survey (0930 GMT+1)
- Raphael Bostic (1430 GMT+1)

Featured Article

China Update

Efforts to lift the economy have been extraordinary
[This has] preempted a further suppression of interest rates across the globe in anticipation of the collective deployment of central bank ‘puts’

We have seen this before.

In 2001 for example, the BoJ's Rinban operations sparked a multi-year uptrend in gold prices and, after a brief but dramatic setback during the global financial crisis in 2008, the introduction of QE programs by the FOMC and other central banks supercharged the subsequent rally, taking gold from below USD 700 per oz to over USD 1,900 per oz in just under three years.

This is not to suggest that there is a unanimity of view in the global central bank community about any return to more accommodative monetary policies and certainly, as we have argued, the ECB for one has the potential to disappoint next week.

However, as things stand, those holding on to plans for policy normalization are the exception, not the rule – a fact that has indirectly contributed to an unprecedented and extraordinary pile of negative yielding debt which stands $12 trn high.

When we also consider the fact that central banks continue to build their reserves of gold (with buying at or around its highest in 50 years), the current, heady mix of support for gold presents itself as a possible precursor to something of long-term significance.

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