Gold – soft metal, hard currency

Back

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- The remonetisation of gold has begun; trust in paper currencies is waning
- For the first time, investor demand exceeds demand of jewellery industry
- Gold price: USD 2,300 by 2012; upward trend expected to accelerate
- No gold bubble in sight

Gold has been the best asset class over the past ten years. Since 2001, its price has increased almost fivefold; in euro terms it has risen by about 13.5% annually. The rise in the gold price is still not perceived as sustainable, however. Due to gold purchases by the national banks of India, Saudi Arabia and China, central banks were net buyers for the first time in 20 years. Erste Group analysts view this as a new phase of the bull market. As trust in paper currencies steadily diminishes, the stable value of gold, as proven over many centuries, is manifesting itself once again. The best proof that the current price level is anything but a gold bubble is a comparison of public debt and gold holdings. If 10% of US public debt were to be covered by gold, the gold price would have to climb to USD 4,500. In the medium run, experts currently forecast a gold price of about USD 2,300. On a one-year horizon, they project a price of USD 1,600 per ounce.

Gold is the perfect portfolio insurance

Investor demand for gold is continuing its uptrend. In 2009, it rose to 1,270 tons. Especially ETFs (594 tons) were up significantly. Gold is expected to gradually account for an increasing share of asset allocation. Major hedge funds also find gold more and more alluring. Gold is often said to be the investment of choice for prophets of doom, pessimists and fear mongers betting on the collapse of the financial system. „The fact that gold is an excellent portfolio insurance with a history going back over thousands of years is frequently overlooked," says Ronald Stöferle, Erste Group's gold analyst. Also, people remember that the possession of gold does not depend on any promises made by governments, institutions, or individuals.

Soft metal, hard currency – the remonetisation of gold has begun

Gold is the currency that the free market has chosen in the course of the last millennia. Gold has always been an indicator of the health of financial systems, monetary systems, and inflation. While the limelight is currently on the Euro zone, the turbulence there should not divert attention from the much greater woes of the US and Great Britain. Gold is an excellent benchmark for the quality of paper money. It is not exposed to any liquidity risks and is accepted and traded world-wide around the clock. Nor does gold come with any credit risk, as it will never lose all of its value.

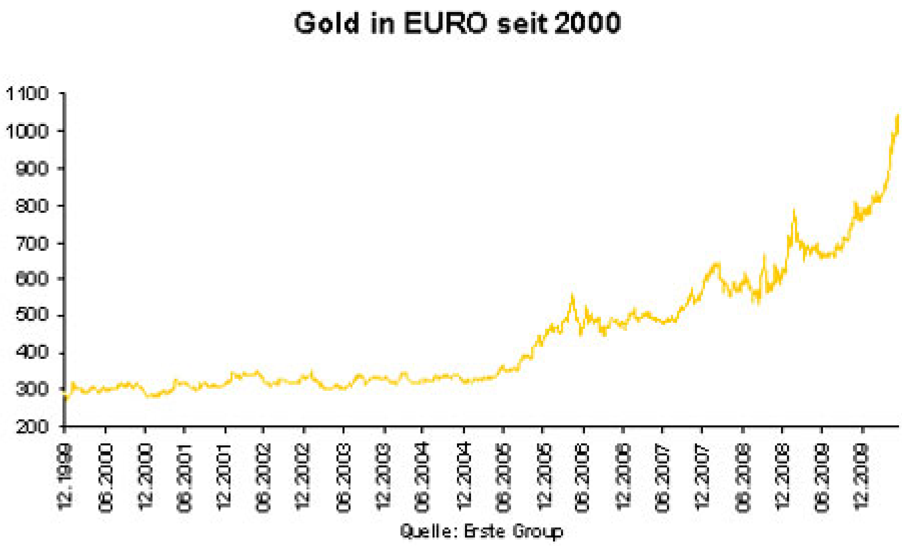
„Practically all paper currencies clearly depreciate against gold in the long term. We do not believe that the problems we are facing can be solved within a matter of days," Stöferle explained his positive outlook for the gold price.

Additional factors supporting a rise in the price of gold:

- Gold and precious metals are the only asset class that retains its value in both inflationary and deflationary settings on a sustainable basis.
- A rapid expansion of production capacities appears extremely unlikely. Soaring production, energy and wage costs have partly more than offset the gold price increases. In addition, easily minable reserves are largely exhausted, which means the metal has to be mined at greater depths, which makes production more costly. Our 'peak gold' scenario thus appears to remain intact.

■ The credit crisis is not over yet. US macroeconomic data paint an ambivalent picture of the US economy and the problems in the US commercial real estate market are mounting. The much-quoted double-dip recession cannot be ruled out.

■ Die Kreditkrise ist noch nicht vorbei, die US-Makrodaten zeigen ein zwiespältiges Bild der US-Wirtschaft und die Probleme am amerikanischen Gewerbeimmobilienmarkt nehmen zu. Die vielzitierte „douple dip“- Rezession kann nicht ausgeschlossen werden.



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Decoupling from the dollar
In 2010 the gold price decoupled from the development of the dollar. Recent trends show that a stronger dollar does not necessarily translate into a softer gold price. Gold has retained its elevated price level despite the dollar rally and has reached a new all-time high. This is remarkable given its weak seasonality and might also be an argument in favour of a new phase in the bull market. Bull markets in gold are characterised by two extremely strong human emotions: fear and greed. It may well be a combination of these two factors that may cause gold to go parabolic in the final phase of the trend. As a result, Erste Group analysts expect gold to hit the long-term target price of USD 2,300 at the end of the cycle.

No gold bubble in sight
Many market players find it hard to differentiate between a bull market and a bubble. As a number of historic examples show, we are definitely not seeing a gold bubble at present. The value of US gold holdings currently amounts to about 1.85% of US GDP. In 1940, it was above 20%, in 1980 close to 7%. A comparison of gold with historical money supply also suggests that the current price level is attractive. If the narrowly defined money supply (M1) were to be covered 45% with gold - similar to the situation in 1980 - the gold price would have to rise to about USD 10,000. To cover the more broadly defined money supply (M2), the gold price would even have to climb to USD 30,000. The opportunity/risk profile for gold investments remains excellent. Based on the fundamental technical assumption that “resistance becomes support”, the USD 1,000 threshold seems to provide firm support. Analysts do not believe that the price of gold will fall below this level in the year ahead.

Spezial Report [pdf; 1.6 MB]

Back