# Gold is king in times of negative real interest rates

**11.07.2012**

- **Prolonged negative real interest rates and global debt crisis set to push gold price higher**
- **Soaring gold price: 12-month target USD 2,000, long-term target USD 2,300 (current price USD 1,590)**
- **70% of total demand for gold comes from emerging markets**
- **Central banks increasingly favor gold: in 2011 they bought as much gold as in 1964**
- **Gold belongs in the portfolio: Portfolio protection still inexpensive and massively underweighted among institutional investors with 0.15%**

The price of gold is yet to peak, bolstered by low real interest rates and the desire for secure, sustainable forms of savings and investments, according to the latest Erste Group report “In Gold We Trust”. As the Federal Reserve will continue its zero interest policy until at least 2014, real interest will continue to be negative, laying the ground for gold price to climb higher. “Since the last Erste Group Gold Report of July 2011, the price of gold in euro has risen by 26%. Over the short term, it would seem that the seasonality implies a continued sideways trend; however, the phase of the best season for gold begins in August. Therefore, our next 12-month target is USD 2,000. As we still have the parabolic trend phase ahead of us, we expect as long-term target at least USD 2,300 at the end of the cycle,” explained Ronald Stöferle, commodity analyst at Erste Group and author of the report.

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The key question of whether inflation or deflation will be the determining factor for markets in the coming years remains unanswered. In inflationary times, real assets are the preferred type of asset class, while during deflation it is cash. Gold is liquid, divisible, indestructible and easy to transport. At the same time it is a simple, affordable, time-tested, and reliable good for protecting oneself against the massive tail risks that we are currently facing.

Furthermore, there is a global market for gold and there is no risk of default; thus gold is being viewed more and more as high quality cash and less as a commodity, and this is driving the price steadily upwards.

**Prolonged negative real interest rates and global debt crisis set to push gold price higher**

Ronald Stöferle points out that one reason for gold’s excellent performance is the relative scarcity of the precious metal compared to arbitrarily printable bank notes. “Gold is so highly valued because annual production in relation to reserves is so low. Gold reserves are growing at around 1.5% per year. In contrast, the money supply aggregates are growing at multiple times this rate”. Additionally, the appeal of gold as a secure form of saving goes up precisely in economically uncertain times. “The European Central Bank has just lowered

Gold price in EUR and USD since the previous Gold Report interest rates to an all-time low and it looks as if these will stay there for some time to come. Negative real interest is a perfect environment for gold," explained Erste Group's gold expert.

Source: Datastream, Erste Group Research

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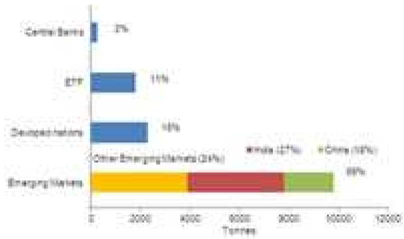
The current high purchasing value of gold can be best illustrated by the following example: "If one compares the price of beer to the price of gold, one would be able to buy around 136 Maß (one Maß = one litre) of beer at this year's Munich "Oktoberfest" for one ounce of gold. The mean value is historically at 87 Maß. The peak was reached in 1980 when you could have bought 227 Maß of beer," Stöferle said chuckling.

**70% of total demand for gold comes from emerging markets**
The hunger for gold in emerging markets is also responsible for the rising price. While in 1980 Europe and the US still accounted for 70% of global gold demand, now it is barely 20%. Within the past five years, the share of emerging markets in the overall global demand for gold rose to 70%. More than half of it was in China and India. Apart from the strong traditional affinity to gold (especially in India), growing demand and the increasing savings ratio in emerging markets are attributable to greater prosperity. However, local investors' options are very limited in terms of how they use their savings. In this respect, gold has over centuries been proven the best asset to preserve value. "Assuming that incomes in China and India continue to rise and real interest stays negative or low, gold will automatically benefit from this development," said Stöferle.



**Aggregate gold demand 2007 to 2011**
Source: Bloomberg, Erste Group Research

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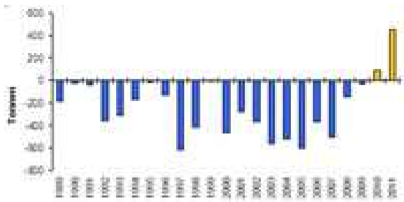
Moreover, criticism of the hegemony of the USD as a currency is growing: many nations apparently want to liberate themselves from the slavish link to the US currency. China, Russia and India but also Japan are increasingly showing a desire to settle bilateral trades in their own currencies or in commodities to avoid the US dollar. This is a clear indication of a shift in paradigm especially as more than 2/3 of all US dollars are held abroad.

**In 2011 central banks bought as much gold as in 1964**
Central banks are also following the global gold trend. According to the International Monetary Fund (IMF), the US dollar is still the largest of all global reserve currencies with a huge share of 61.7%. 27.5% is held in euro, the remaining 12.6% in gold and other currencies. "This share is likely to change enormously in the future," Stöferle believes. Because: "In the previous year, it was especially central banks that bought as much gold as they last did in 1964." According to a survey of 54 central banks, which are responsible for portfolios totaling USD 6,000 billion, 71% of those interviewed said that gold had clearly gained popularity in the course of the euro crisis.



**Net purchases and sales by central banks in tonnes**
Source: WGC, Bloomberg, Erste Group Research

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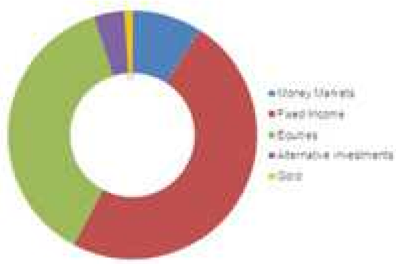
**Gold is safe haven asset and belongs in every portfolio**
"Gold has certainly become more attractive as a 'safe haven asset' in times of turbulence on global financial markets," stated Stöferle. Gold easily meets the requirements to be considered a "safe haven asset" (low credit and market risks, high market liquidity and low inflation and exchange rate risk). "Everyone is talking about gold, but it is not on all portfolio accounts: Gold is still weighted at merely 0.15% in institutional portfolios. Similarly low allocations are also seen in the case of gold mining stocks."



**Allocation of institutional managed assets (currently USD 146 trillions)**
Source: World Gold Council, BIS, Hedge Fund Research, J.P. Morgan, Preqin, Thomson Reuters, GFMS, World Federation of Exchanges

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Gold Report [pdf; 2.3 MB]