COMMENTS 16:25 - 25/07/13

The gold price will remain volatile

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"It is nonsense to say the rise in gold prices was merely a speculative bubble. »

Neither the striking drop in the gold price nor the recent temporary recovery do something about its long-term determinants. A commentary by Kenneth Rogoff.

Possession of gold (gold 39463 0:04%) (Gold 1310 -1.21%) is a form of insurance against war, the collapse the financial system and an all-encompassing currency devaluation. Since the beginning of the global financial crisis, the gold price is often referred to as a barometer of global economic uncertainties. Is the slump in gold prices - from a peak of $ 1,900 an ounce in August 2011 to less than $ 1,250 beginning in July 2013 - more noteworthy as a vote of confidence in the global economy?

Personal

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The finding of the gold market, all the classic signs of a burst bubble, is an excessive simplification. Undoubtedly left the heady gold price increase, starting from about $ 350 per ounce in July 2003, advised investors in ecstasy. The price rose every day, because we were all convinced that he would rise even higher the next day. Doctors and dentists began to sell off stocks and buy gold coins. In India and China, demand for gold jewelry rose rapidly. Central banks in emerging markets diversified their portfolios by selling dollars and invested in gold.

Increasing demand

There were several strong arguments for buying gold. Ten years ago, the gold price was a lot lower than the long-term inflation-adjusted average, and the integration of three billion people of the developing countries into the world economy could only lead to a gigantic long-term increase in demand for gold.

This part of the story is, moreover, still. The global financial crisis gave the gold added appeal because it was afraid of a second Great Depression. After some investors feared that governments would allow inflation to rise, to get rid of the burden of the rapid increase in public debt and to tackle the problem of persistent unemployment under control. As the central banks lowered interest rates to zero, no one was interested in that gold does not generate any interest. Therefore, it is nonsense to say the rise in gold prices was merely a bubble. However, it is already true also true that with the rise in the gold price would also enter a growing number of naive investors.

Lately, the fundamentals have progressed quite a bit, and the speculation is even stronger noise subsided. China's economy weakens further, and India's growth rate in recent years has experienced a drastic decline. In contrast, the U.S. economy seems to come despite the unwise automatic spending cuts gradually back on their feet. The global interest rates have risen by 100 basis points since the U.S. Federal Reserve (Fed) - has announced that it will be the policy of quantitative easing expire - rather prematurely, as it seems to me.

Now that the Fed's anti-inflation stance gives emphasis, it is difficult to argue that investors need gold as a hedge against high inflation. And after the doctors and dentists who bought gold coins two years ago, they sell now, is not yet clear whether the downward spiral in gold prices has really found its end.

Safeguarding

Indeed, the arguments for or against gold since 2010 have not changed too much. This faith-based speculative investment - - In October of the same year, the price of gold was on the way up and had just reached the milestone of $ 1,300. But the real argument for owning gold was then as now, not speculative in nature. Gold is rather a hedge. If you are a high or a sovereign wealth fund investors more solvent, it is sensible to keep a small percentage of your assets to hedge against extreme events in gold.

Sensibly, the possession of gold and for people of the middle class and poor households in those countries - be that strictly limit access to alternative investments - such as China or India. For most other gold is a game among many, where you can indulge. And like all gambling games this is not necessarily profitable.

The gold market will inevitably remain risky and volatile, except that governments set the price of gold fixed, as they have done before the First World War. In a study published in January, economists Claude Erb and Campbell Harvey examine several possible models of a basic price for gold and come to the conclusion that gold with these models is at best loosely related.

Rather, the gold price seems to fluctuate over extended periods well above or well below its long-term fundamental value. In this respect he is no different from many other investments such as foreign exchange or equities, although the changes in the price of gold may take extreme forms.

In order to demonstrate that the long-term value of gold for thousands of years has remained stable, proponents of this theory often cite isolated historical data. How about Stephen Harmston refers to a widely cited study from 1998, based on reports of evidence that one with an ounce of gold could buy 350 loaves of bread to the time of King Nebuchadnezzar of Babylon, who died in 562 BC. Besides the fact that bread in Babylon was probably healthier than today's highly refined products, the current gold price does not differ so much from that time. Today, you may get 600 loaves of bread for an ounce of gold.

Of course we do not have annual data on the development of the Babylonian gold price. We can, under the assumption of wars and other uncertainties only assume that the true market price at the time - was subjected to quite a variation - as well as today. The recent collapse in the gold price has not really changed so the case for investing in gold in one form or another. Prices could very easily fall under $ 1000, but then rise again. However, the politicians should be careful to interpret the collapse of the gold price as a sign of confidence in their work.

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