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How to interpret the fall in gold

Kenneth Rogoff - In principle, holding gold is a form of insurance against war, a financial Armageddon and a massive currency depreciation. Thus, from the onset of the global financial crisis, the price of gold has often been portrayed as a barometer of global economic uncertainty.

CAMBRIDGE - Therefore, should we see the collapse in the price of gold - a peak at \$ 1900 an ounce in August 2011 to less than \$ 1,250 in early July 2013 - a vote of confidence in the economy World?

That the gold market shows all the classic characteristics of a bubble that burst would be simplistic. There is no doubt that the heady gold climbing to its summit, starting from about \$ 350 an ounce in July 2003, has investors salivating. The price increased today because everyone was convinced that he would continue to rise tomorrow.

Doctors and dentists began to sell their stocks to buy gold coins. The demand for gold jewelry in India and China has increased. Central banks in emerging markets have begun to diversify their reserves by selling dollars for gold.

The argument in favor of buying gold were several solid components. Ten years ago, gold was selling well below its long-run average adjusted for inflation, and integration into the global economy than three billion people from emerging markets could only mean one shot giant thumb and sustainable demand.

This element of the story, moreover, remains valid. The global financial crisis has added to the attractiveness of gold, primarily because of the fear of a second Great Depression. Later, some investors were concerned that governments generate inflation to ease the burden of soaring public debt and the continuing fight against unemployment.

When central banks gradually brought the key interest rate to zero, nobody cared that gold provides no interest. It is absurd to say that the rising price of gold was a bubble. But it is also true that the price increase has prompted a growing number of naive investors to buy.

Lately, of course, the fundamentals are somewhat reversed and the speculative frenzy was reversed more. The Chinese economy continues to slow, the growth rate of India is much lower compared to a few years ago. However, despite the misguided budget sequestration, the U.S. economy seems to be on the mend. Global interest rates have increased by 100 basis points since the Fed began to suggest - fairly early, in my view - that its quantitative easing policy could draw to an end.

Since the Fed has demonstrated its significant bias against inflation, it is more difficult to argue that investors need gold as a hedge against high inflation. And while doctors and dentists who had bought gold coins two years ago are now starting to sell, it is difficult to predict at this stage will be located where the end of the downward spiral in the price of gold . Some target the compelling the psychological barrier of \$ 1,000.

In fact, the argument for or against gold has not changed that much since 2010, when I wrote the last time on this. In October this year, the price of gold - the active speculative based on trust through excellence - began to rise, having just reached the \$ 1,300. But the real argument in its favor, then as now, has never been speculative. Instead, gold is a hedge. If you are an investor with a high net worth, or a sovereign fund, it makes perfect sense to have a small percentage of your assets in gold as a hedge against extreme events.

Holding gold may also make sense for households in the middle and lower class in the country - for example, China and India - which significantly restrict access to other financial investments. For most other people, gold is just another challenge that we can do. And, like all paris, it is not necessarily the winner.

Unless governments do not set the price of solid way as they did before the First, the gold market will inevitably risky and volatile World War. In a study published in January , economists Claude Erb and Campbell Harvey consider several possible models to determine the basic price of gold and conclude that they are at best only weakly associated with the actual development of the gold price . Instead, the price of gold often seems to drift far above or below its fundamental long-term value for extended periods. (This behavior, of course, is reminiscent of many other financial assets, such as exchange rates or equity prices, although fluctuations in gold prices may be more extreme.)

Fans of gold sometimes cite isolated historical data suggest that the long-term value of gold has remained stable over millennia. For example, the oft-cited study by Stephen Harmston 1998 mentions anecdotal evidence that an ounce of gold bought 350 loaves of bread at the time of Nebuchadnezzar, king of Babylon, who died in 562 BC. BC. Ignoring the fact that the bread Babylon was probably better for health than highly refined product today, the price of gold today is not so different, perhaps equivalent to 600 loaves of bread .

Obviously, we do not have annual data on the price of the Babylonian gold. We can only assume, given the wars account and other uncertainties, the actual market price at the time, as now, were very volatile.

Thus, the recent fall in the price of gold has not really changed the need to invest in one direction or the other. Yes, prices could easily fall below \$ 1000, but again, they might start to rise. Meanwhile, policymakers must be cautious in interpreting the fall of gold prices as a vote of confidence in their performance.

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