Gold Tells a Shocking Story in Venezuelan Currency Terms

Mark Hulbert writes that one shouldn't assume gold is always a good hedge against inflation.

By Mark Hulbert
Jun 11, 2019 6:59 AM EDT

Gold's performance in Venezuelan-Bolivar terms comes as a shock to those who blithely assume that the yellow metal is a good hedge against hyperinflation.

This isn't to say gold hasn't put up a valiant effort. It has risen 10,700% in Bolivar-denominated terms since the end of August, according to Bullion Rates.

But it still hasn't come close to keeping up. According to Claude Erb, a former commodities and fixed income manager at TCW Group, the real price of gold in Venezuelan currency terms has fallen more than 60% over the same period.

Erb argues that we shouldn't be surprised by gold's falling short. In a study Erb co-wrote several years ago and circulated by the National Bureau of Economic Research, gold often is a poor hedge against hyperinflation. Erb's co-author was Campbell Harvey, a finance professor at Duke University.

One other example the two researchers focus on: Brazil between 1980 and 2000, during which inflation rose nearly 13 million percent, according to World Bank data. Over that same period, according to Erb and Harvey, the real price of gold in Brazilian currency terms declined 70%.
The real price of gold in U.S. dollar terms also fell by nearly the same amount over those two decades, and Erb says that this is not just a coincidence. He argues that, once you adjust for currency fluctuations and differential inflation rates, gold's real return should be more or less the same regardless of the currency in which it is denominated. "Even though countries... may experience very different inflation experiences their real gold return experiences will probably be similar," Erb and Harvey argue in their study.

Note that, even though we should expect gold's real returns to be more or less the same regardless of the currency, that doesn't mean those returns won't still fluctuate significantly over time.

Another of Erb's and Harvey's key findings is that those returns fluctuate quite widely. Sometimes gold's real return will be positive, and at other times negative -- as it was between 1980 and 2000. In fact, they found, gold's real return fluctuates just as much as it does in nominal terms.

That means that gold is not a good hedge for any type of inflation, not just hyperinflation.

To be sure, gold's true believers are right in one sense that bullion is a good inflation hedge.

But, according to Erb's and Harvey's research, this is the case only when measured over extremely long periods of time -- measured over many, many decades, if not centuries. Over shorter periods whose length is relevant to our own investment horizons, unfortunately, gold is an inferior inflation hedge.

Perhaps the best inflation hedge for shorter horizons are Treasury Inflation-Protected Securities, or TIPS. They are U.S. Treasury notes or bonds whose principal is guaranteed to grow in lockstep with the U.S. Consumer Price Index. And, since we should expect gold's real return in the U.S. to be similar to its return in any other currency, TIPS should be a good inflation hedge regardless of your home currency.
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