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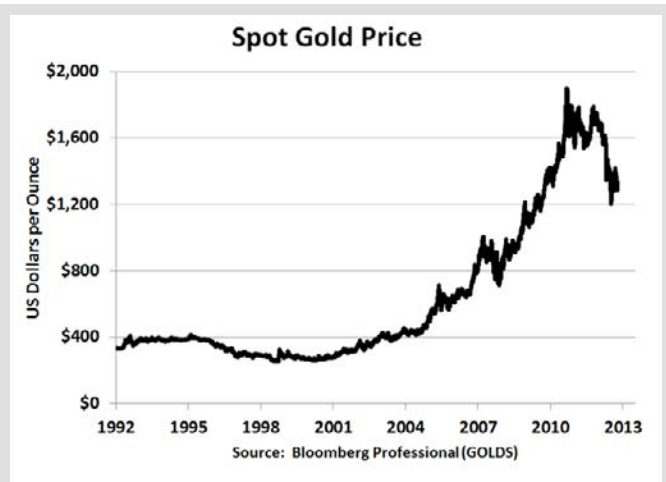
Gold: Market Volatility Likely, No New Trends

Gold is being buffeted by a number of conflicting forces. The result has been volatility within a wide trading range. No new trends with any persistence are likely to develop until some of the critical influences that oppose each other give way.

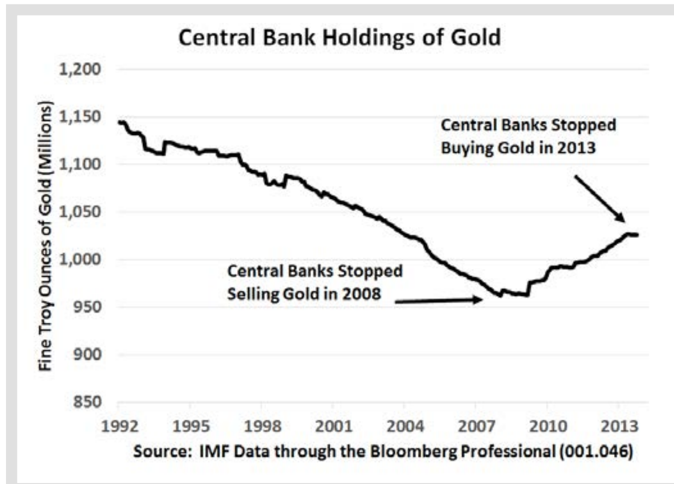
Figure 1.



Central Banks No Longer Supporting the Gold Market

In 2007-2008, central banks shifted away from their decade-long preferences for selling gold and began accumulating gold. More recently, central bank activity in 2013 suggests the appetite for buying gold has been whetted. Or more likely, the losses sustained as the gold price came off its peak have given central bankers (and others as well) pause for thought as to what is the right amount of gold to hold in their portfolios. Whatever the reason, central banks are no longer a source of demand for the gold market.

Figure 2.



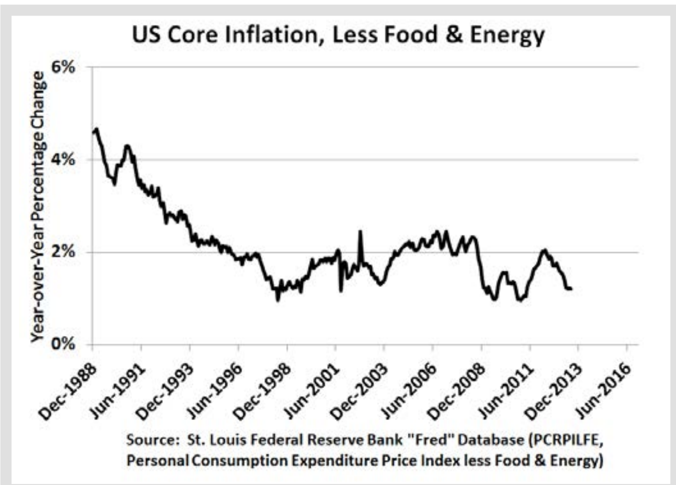
Jewelry Demand Sluggish from India and China

India and China are the largest buyers of gold for jewelry in the world. India has been worried about its negative balance of trade and has been raising tariffs on gold imports to slow demand. And while for different reasons, both India and China have been in a growth deceleration period, which has also slowed the demand for gold. Absent a sustained period of accelerating economic growth, demand for gold from India and China is likely to remain much more subdued than it was in the previous decade, when they helped to drive the bull market for gold.

Little Inflation Fears in US Dollar Terms Despite Fed QE Programs

Gold is also a well-regarded hedge against future inflation. A rising US dollar price of gold and the fears of US dollar inflation often go hand in hand. Currently, there are no signs of inflationary pressures developing in the US. While the massive quantitative easing program of the Federal Reserve is a source of long-term inflation worries for many, the Fed's asset buying programs have done little so far to promote economic growth, create jobs, or set inflation forces in motion. About all that can be said for the QE programs is that they lowered the yield on long-term Treasury securities below what it otherwise might have been. Nevertheless, the likelihood that the Fed will keep its target federal funds rate pegged near zero for an extended period of time into the future remains a support for gold.

Figure 3.



Portfolio Uncertainties

From a portfolio perspective the case for gold as a diversifying asset remains intact. From a price appreciation perspective, however, the lack of central bank buying, sluggish demand from India and China, and the absence of inflationary pressures in the US all weigh against gold resuming its rally. Even the US government shutdown, which certainly raised fears of economic disruption, weighs negatively on gold since the shutdown and debt ceiling debate hit economic growth expectations and can be considered deflationary forces. The two possible scenarios most likely to result in higher gold prices are (1) rising economic growth in India or China or (2) an emergence of inflation pressures in the US. Neither of these forces are in play at the moment.

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