Global Financial Markets

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Eddy Markus, Founder & Chief Economist

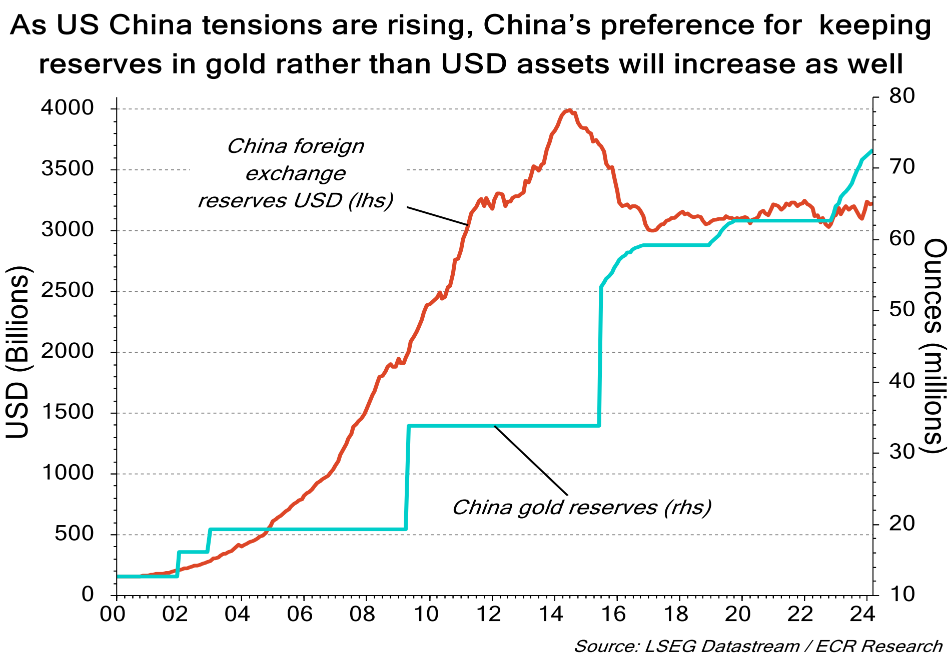
Gold on the verge of breaking out

The price of gold - like the price of bitcoins - has been rising rapidly of late. At the time of writing, the price has risen above $2,150, which, from the perspective of a technical analysis of charts, paves the way for an uptrend to $2,500 - $3,000.

This positive development is basically surprising, as Western central banks are currently depressing inflation via high (real) interest rates. This forms a negative climate for gold.

One might counter this by arguing that interest rate markets still assume that the ECB and the Fed will shortly proceed with rate cuts. This prospect could boost the gold price. This argument does not really appeal to us, however, as interest rate markets have actually sharply reduced their expectations in terms of the extent of rate cuts by Western central banks.

We are seeing more and more signs that the surge in demand for gold is originating from managers of large funds outside the West and especially from China. We have mentioned before that managers of non-Western large reserve funds are no longer eager to hold their assets in the West. They fear that the West could too easily block/confiscate assets. In this case, gold is a sound alternative.



Chinese citizens are also increasingly fleeing into gold. Indeed, China is experiencing a crisis in its property and stock markets. A growing number of Chinese have invested/speculated abundantly in these markets over the last decades. In fact, one can compare this to the events in the West after 2009. To avoid deflation, the economy's demand side had to be strongly stimulated - preferably through additional wage increases, but this was thwarted by globalisation. As there was at that time no willingness to drive public deficits far higher, there was only one remaining option: businesses and consumers had to be encouraged to step up borrowing (in China's case, this also applied to local governments).

To achieve this, central banks created far more money than the real economy was able to absorb. The surplus money therefore largely flowed into shares, property and higher-yielding riskier bonds. This drove up prices to exceedingly high levels, as a result of which balance sheets increasingly improved. This, combined with low interest rates, resulted in far more credit activity. The latter has led to bubbles in property and stock markets, especially in China. Also, governments were getting deeper and deeper into debt.

Chinese President Xi Jinping wants to base economic growth far less on debt accumulation. Indeed, he wants to depress the total debt/GDP ratio. This is why it has become far more difficult to obtain loans in China. This situation is dealing the many speculators in property and shares severe blows. At this point, Beijing is trying to ensure that the bubbles slowly deflate rather than burst.

But savings are still high in China. So, where should the Chinese take their savings, considering that investment in property and shares has become far less appealing? Investing overseas is probably a good alternative, but in China one cannot simply exchange the domestic currency for other currencies. So, against this background, gold seems by far the best alternative. This also applies to crypto currencies in the case of mostly younger investors.

We would therefore not be surprised if, despite the fact that Western monetary policies remain fairly tight, the gold price keeps rising rapidly. However, it has become significantly overbought in the process. This means that a correction to around $2,000 is quite possible. In the ensuing period, however, a further rise to $2,200-2,250 is likely.

The price of gold could subsequently fall back to around $2,000 once it becomes clear that US interest rates will remain high for the time being. However, this will present a favourable buying opportunity for the Chinese. Hence, we expect the gold price to start an uptrend to $2,500 if not higher; certainly when it becomes more clear that Trump will be re-elected, as this would make it increasingly less appealing for Chinese savers to invest in the West.