

Editor:

Tasos Anastasatos:

Senior Economist

tanastasatos@eurobank.gr

Written By:

Maria Prandeka:

Economic Analyst

mprandeka@eurobank.gr

Gold is likely to continue to provide a safe haven to investors

- Gold prices have climbed to all-time nominal highs of \$1895/toz in early September 2011, benefiting from the official sector's return as net gold buyer and from investors seeking protection against growing concerns over the sovereign debt crisis.
- The medium term outlook for gold is positive since the same factors that pushed gold prices to historical nominal highs are expected to shape price dynamics over the next quarters.
- Inverted US 10 year real yields, which exhibit a very strong correlation with gold, are likely to decline further, suggesting upside risk to gold prices.
- However repetition of short-term price corrections cannot be ruled out, considering further liquidations for profit taking by short-term investors losing money in other asset classes.

DISCLAIMER

This report has been issued by EFG Eurobank Ergasias S.A. (Eurobank EFG), and may not be reproduced or publicized in any manner. The information contained and the opinions expressed herein are for informative purposes only and they do not constitute a solicitation to buy or sell any securities or effect any other investment. EFG Eurobank Ergasias S.A. (Eurobank EFG), as well as its directors, officers and employees may perform for their own account, for clients or third party persons, investments concurrent or opposed to the opinions expressed in the report. This report is based on information obtained from sources believed to be reliable and all due diligence has been taken for its process. However, the data have not been verified by EFG Eurobank Ergasias S.A. (Eurobank EFG), and no warranty expressed or implicit is made as to their accuracy, completeness, or timeliness. All opinions and estimates are valid as of the date of the report and remain subject to change without notice. Investment decisions must be made upon investor's individual judgement and based on own information and evaluation of undertaken risk. The investments mentioned or suggested in the report may not be suitable for certain investors depending on their investment objectives and financial condition. The aforesaid brief statements do not describe comprehensively the risks and other significant aspects relating to an investment choice. EFG Eurobank Ergasias S.A. (Eurobank EFG), as well as its directors, officers and employees accept no liability for any loss or damage, direct or indirect, that may occur from the use of this report.

In a period of economic uncertainty and increased volatility across the markets, gold prices have climbed to all-time nominal highs of \$1895/toz in early September 2011, benefiting from safe haven demand (Figure 1). Gold's price gains for the year to date are now standing at about 20%. The price upturn was mostly driven by the official sector's return as net gold buyer and from investors seeking protection against the growing fears about the impact that the sovereign crisis in the US and Europe will have on the real economy.

Meanwhile, gold prices slipped to below \$1700/toz at the end of September, as turmoil in global financial markets led investors losing money in other asset classes to leave the market in favour of cash, ignoring the safe-haven appeal of gold. Nevertheless, the medium term outlook for gold is positive since the same factors that pushed gold prices to historical nominal highs are expected to shape price dynamics over the next quarters.

In particular, there is still heightened uncertainty concerning the extent of the sovereign debt crisis and most importantly the potential spillovers to the real economy. Moreover, inverted US 10 year real yields, which exhibits a very strong correlation with gold (Figure 2), are likely to decline further. One main reason for this is US Federal Open Market Committee's (FOMC)¹ announcement of "Operation Twist". This policy is attempting to reduce long-term US interest rates by changing the composition of its balance sheet. Under such a scenario, real long-term yields are likely

Figure 1



Source: Ecwin

¹ See our Global Markets Special Focus Report: The Fed launches Operation Twist to abate significant downside risks to the US outlook (September 30, 2011).

September 30, 2011

FOCUS NOTES

to decline, due to the dual effect of lower nominal rates and an increase in future inflation expectations. This suggests upside risk to gold prices.

Figure 2



Source: Ecowin

In the meantime, according to the World Gold Council (WGC), in 2010, the official sector became a net buyer of gold for the first time in 21 years. This switch of the official sector is in itself a positive factor for gold price dynamics, given that the sector has been a significant supplier of the metal over the period 1989-2007 at an average release of 400-500 tones/year. It's worth noting that central banks of major emerging economies, such as Russia, Mexico, Thailand and South Korea have added to their reserves this year, in a move to reduce their exposure to the dollar. We believe that the official sector will continue to purchase gold, as a result of intensifying concerns over sovereign debt issues and the turbulence in the currency markets.

Looking at the supply and demand side of the gold market, the data are particularly supportive for gold. According to the latest Gold Demand Trends report from the WGC, demand for gold in Q2 2011 was 919.8 tones –the second highest quarterly value on record. The report notes that demand was broad-based across sectors and geographies, with India and China, once again, the major contributors to overall growth, accounting for 52% of global bar and coin demand and 55% of global jewellery demand. In 2010, jewellery and bar and coin demand accounted for almost 80% of total gold demand. In line with our expectations, the WGC expects gold demand to continue to be supported by China and India for the remainder of 2011. They quote several supporting factors for this, including relative economic prosperity and high inflation rates for both countries and a good monsoon and strong seasonal demand in India. On the supply side, mine production made a positive contribution. However, mine supply growth was offset by declining scrap supply and the official sector switching to a net buyer of gold.

We believe that robust demand coupled with the continuation of the official sector net purchases and scrap supply responding to higher gold prices is expected to keep gold prices at historically high levels in the medium term.

To sum up, we expect that as long as the uncertainty in the global economic environment continues, gold prices will be supported, since safe-haven buying by both the private and official sector will continue to dominate price formation. When heightened worries over sovereign debt issues settle down and increased volatility in financial markets abates, gold's price upward trend might be interrupted. It is worth noting that according to a survey at the London Bullion Market Association precious metals annual conference in Montreal, Gold may surpass \$2000 an ounce in 2012 amid surging investor demand. However, short-term price corrections cannot be ruled out, considering further liquidations for profit taking by short-term investors losing money in other asset classes.

Research Team

Editor, Professor Gikas Hardouvelis

Chief Economist & Director of Research Eurobank EFG Group

Financial Markets Research Division

Platon Monokroussos, *Head of Financial Markets Research Division*

Paraskevi Petropoulou, *G10 Markets Analyst*

Galatia Phoka, *Emerging Markets Analyst*

Sales Team

Nikos Laios, *Head of Sales*

Vassilis Gioulbaxiotis, *Head of International Sales*

Yiannis Seimenis, Ioannis Maggel, *Corporate Sales*

Stogioglou Achilleas, *Private Banking Sales*

Alexandra Papathanasiou, *Institutional Sales*

Economic Research & Forecasting Division

Dimitris Malliaropoulos, *Economic Research Advisor*

Tasos Anastasatos, *Senior Economist*

Ioannis Gkionis, *Research Economist*

Vasilis Zarkos, *Economic Analyst*

Stella Kanellopoulou, *Research Economist*

Olga Kosma, *Economic Analyst*

Maria Prandeka, *Economic Analyst*

Theodosios Sampaniotis, *Senior Economic Analyst*

Theodoros Stamatou, *Research Economist*

Eurobank EFG, 20 Amalias Av & 5 Souri Str, 10557 Athens, tel: +30.210.333.7365, fax: +30.210.333.7687, contact email: Research@eurobank.gr

Eurobank EFG Economic Research

More research editions available at <http://www.eurobank.gr/research>

- **New Europe:** Economics & Strategy Monthly edition on the economies and the markets of New Europe
- **Economy & Markets:** Monthly economic research edition
- **Global Economic & Market Outlook:** Quarterly review of the international economy and financial markets

Subscribe electronically at <http://www.eurobank.gr/research>

