Opinion **Gold**

Gold is back – and it has a message for us

The precious metal's surge may herald a whole new world

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It's easy to mock gold bugs, but their moment may finally have come. The precious metal has been breaking out recently amid higher than expected inflation in the US, and general anxiety over everything from geopolitics to the November presidential elections to where monetary policy and markets go from here.

All these things are predictable reasons for gold to surge. But there are deeper, longer-term messages in this rise that investors should pay very close attention to.

Let's start with inflation. Whatever happens over the next few quarters, I've long thought that we were in for a period of "higher for longer" inflation. Aside from the possibility of a technology-driven productivity miracle, it's hard to think of a macro-trend at the moment that isn't inflationary.

The economy is running hot — from fiscal stimulus in the US to more supply chain redundancy as countries de-risk, to all the capital investment required for the clean energy transition and re-industrialisation in rich countries. Even ageing US baby boomers are likely to be an inflationary force, since they have health, time and plenty of money to spend.

Gold is historically an inflation hedge. But it's also something investors turn to when they are worried about the stability of the status quo. It will languish for decades, then break out when the world is at a major pivot point, as it is now.

It's no secret that the Washington consensus — which expected emerging nations to fall in line with free-market rules written by the west — and the postwar Pax Americana are over. Trade tensions between the west and China are growing. Meanwhile, the weaponisation of the dollar following the outbreak of war in Ukraine has quickened moves in many countries, most importantly China, to sell Treasury bills and buy gold as a hedge against America's financial might. It is easy to imagine this weekend's escalation in Middle East tension boosting gold further.

That pendulum shift has many analysts predicting a massive run up in gold. Philippe Gijsels, the chief strategist for BNP Paribas Fortis, and his colleague chief economist Koen De Leus — the authors of *The New World Economy in 5 Trends* — are predicting gold will rise from its current price of about $2,374 an ounce to reach $4,000 in "the not so distant future". As Gijsels puts it, "this isn't just an interest rate thing. People are hedging against a new world".

I was interested to see a tweet last week by economist Brad Setser noting that China's holdings of US financial assets as a share of its gross domestic product are back down to where they were when the country joined the World Trade Organization in 2001. Not all of that went into gold, of course (much went out of foreign exchange reserves and into China's own beleaguered banks). But it speaks to that changing world.

As a recent report by Currency Research Associates noted, "China buying gold and selling Treasuries mirrors how Europe's central banks began to redeem dollars for gold in the late 1960s as the Bretton Woods System began to break apart."

Indeed, that was the beginning of the last long, sustained run up in gold, between 1968 and 1982, when it rose against both the Dow and the dollar. There are other ways in which that period chimes with today. In 1971 when Richard Nixon, then president, took the US off the gold standard, he also imposed a 10 per cent tariff on imports. This was a kind of unofficial devaluation of the dollar to protect US-made goods from exchange rate fluctuations.

Donald Trump has, of course, proposed a 10 per cent across-the-board import tariff if he's elected to a second presidential term. He has also decried the way in which a strong dollar penalises American manufacturers abroad. But the recent trip to Beijing by Treasury secretary Janet Yellen to protest against Chinese dumping underscores the fact that the Biden administration is equally worried about US industries and workers. I wouldn't be surprised to see some depreciation in the dollar no matter who wins the White House. That, too, would be good for gold, which tends to go up when the dollar weakens.

The final reason to be bullish on gold is the picture on US debt and deficit, which is quickly becoming unsustainable. The most recent congressional Budget Office projections put US debt at 99 per cent of GDP by the end of this year, and have it on track to reach 172 per cent by 2054. If this happens the result would be monetisation, inflation, financial repression and a period of extreme chaos in monetary policy and markets. Bad for the world; good for gold.

Is there any hope of a different outcome? One could imagine inflation eating away some debt. But higher-for-longer rates would create an even more fiscally unsustainable position, given that asset prices and thus tax receipts would be likely to fall.

Gold bull Luke Gromen, who pens an investment newsletter, "The Forest for the Trees", has argued that since the only thing that can be trimmed from the US budget is interest payments (cuts to welfare entitlements and defence spending are not politically viable), the Federal Reserve will eventually be forced to shift direction and lower interest rates so that the US can avoid a debt death spiral.

Yet more easy money would undoubtedly be good for gold. In this strange moment of economic and political paradigm shifts, it seems that most things are.

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